



International Federation of Accountants

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Agenda Item

E

Committee: IAASB Consultative Advisory Group

Meeting Location: Brussels

Meeting Date: June 29, 2007

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

Objectives of Agenda Item

To receive a report on the preliminary analysis of the significant comments on ED-ISA 580 (Revised and Redrafted).

IAASB Task Force

The IAASB Task Force members are: John Fogarty (Chairman); 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-two comment letters were received. (ED-ISA 580 and the comment letters are available at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0070>).

Preliminary Analysis of Significant Comments

Although the majority of respondents expressed general support for the proposed ISA, a preliminary analysis of the comments indicated that respondents were most concerned about the following:

1. *Fundamental Premises.* ED-ISA 580 and proposed conforming amendments to ISAs 200 and 210 explain 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, whether due to fraud or error; and (c) the completeness of information made available to the auditor.

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Some respondents were concerned that the fundamental premises may not be in line with national law or regulation. Some respondents suggested that the general written representations be limited to management's responsibilities established by law or regulation, and those agreed between the auditor and the entity. Some respondents also noted that it is important that the description of management's responsibility in ISAs 200, 210, 580 and 700 are consistent.

2. *Audit Evidence.* ED-ISA 580 explains that audit evidence obtained during the audit may support or contradict the validity of the fundamental premises; however, such evidence is not sufficient without obtaining the general written representations. This is because the auditor may not be able to judge management's knowledge, judgments or intentions solely on other audit evidence.

ED-ISA 580 also requires the auditor to obtain written representations regarding specific assertions in the financial statements when the auditor considers it necessary to corroborate other audit evidence. It notes that specific written representations are particularly relevant in relation to assertions that involve judgment or intent, or that may not be complete; however, they do not constitute sufficient appropriate audit evidence by themselves.

Some respondents requested that the IAASB clarify whether written representations are in fact audit evidence. Few respondents were concerned about the term "corroborate." Few respondents supported the approach in extant ISA 580, which 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. Few respondents also noted that ED-ISA 580 is unclear about whether requirements for written representations in other ISAs (such as those in ISAs 240, 250 and 450) are general or specific written representations, and consequently, whether or not a disclaimer of opinion would be appropriate if those written representations are not obtained.

3. *Relevant Parties.* ED-ISA 580 defines "relevant parties" as: "Parties responsible for preparing and presenting the financial statements and assertions therein. Regarding specific assertions, relevant parties may also include individuals who have specialized knowledge about those specific assertions and are part of the process followed in preparing and presenting the financial statements and assertions therein."

ED-ISA 580 requires the auditor to determine the relevant parties from whom general and specific written representations are to be requested, and to request that they provide such written representations based on their knowledge and belief, having made appropriate inquiries for them to be able to provide such representations.

Comments included requests to clarify the distinction in ED-ISA 580 between references to "management" and those to "relevant parties;" to consider whether the general written representations should be obtained from those charged with governance rather than management; and to consider whether it is appropriate to obtain written representations from parties other than management (or those charged with governance). Some respondents also suggested that the reference "having made appropriate inquiries" be clarified.

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4. *General Written Representation regarding the Financial Statements.* The explanatory memorandum accompany ED-ISA 580 notes that, in approving the proposed ISA for public comment, some IAASB members were concerned about the details of the general written representations regarding the financial statements. In particular, they were concerned about the third bullet of ED-ISA 580.8, which requires relevant parties to state whether specific matters, where relevant in view of the applicable financial reporting framework, have been recognized, measured or disclosed in accordance with that framework. They suggested that the sub-bullets be moved to the application material. The majority of IAASB members, however, took the view that the detailed elements of the general written representation were required in order to reinforce the implications of the overall general written representation about the preparation of the financial statements in accordance with the applicable financial reporting framework. Retaining these details would help to avoid misunderstanding, and thereby improve the quality of the representation received.

Many respondents were also concerned about the detail and completeness of the elements of the general written representation regarding the financial statements. They suggested that the detailed elements be moved to the application material.

5. *General Written Representation regarding Internal Control.* The explanatory memorandum accompanying ED-ISA 580 notes that all IAASB members agreed that relevant parties should be requested to confirm that they acknowledge and understand their responsibility for designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement. Some IAASB members, however, were concerned about requesting relevant parties to confirm whether they believe that the internal control they have maintained is adequate for that purpose. They were of the view that the requirement will be interpreted as requiring relevant parties to assess the effectiveness of internal control.

Many respondents noted that it is not clear what relevant parties are required to do to provide the general written representation about the adequacy of internal control. Some respondents were concerned that management (or the lawyers) may interpret it as requiring a costly, comprehensive assessment of internal control before it can faithfully make such a representation. It was also noted that inconsistencies between the wording of national law or regulation and the wording of the general written representation are likely to give rise to disputes as to the appropriateness of the representation being requested and a reluctance to provide the representation.

Some respondents suggested that the requirement be limited to a general written representation that relevant parties acknowledge and understand their responsibility for designing, implementing and maintaining internal control relevant to preparing and presenting financial statements that are free from material misstatement, whether due to fraud or error.

Few respondents suggested that, as an alternative, the general written representation state that management has disclosed to the auditor all material weaknesses in internal control that it is aware of.

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6. *Date of Written Representations.* ED-ISA 580 requires the general written representations to be as of the same date as the auditor's report on the financial statements. The explanatory memorandum notes that an IAASB member was of the view that the date of the general written representations should be the same date as the approval of the financial statements. Although few respondents supported this view, many respondents were of the view that the date of the general written representations should be the same date as the auditor's report. Some respondents suggested that the text be changed to indicate a date as near as practicable to the date of the auditor's report.
7. *Disclaimer of Opinion.* The explanatory memorandum accompanying ED-ISA 580 notes that some IAASB members were concerned about the requirement for the auditor to disclaim an opinion on the financial statements when relevant parties do not provide the general written representations about the premises, relating to management's responsibilities, on which an audit is conducted. Their concern was that this did not give scope for 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. The majority of IAASB members, however, were of the view that a failure to provide a specific element of the general written representations would undermine the validity of a general written representation itself.

The majority of respondents requested greater flexibility, allowing the auditor to apply professional judgment. Some indicated that their concern may be less if the matters relating to the detailed elements of the general written representation regarding the financial statements and the general written representation regarding the adequacy of internal control are addressed.

Action Requested

The IAASB CAG is invited to share any suggestions with regard to the comments that they may.