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IAASB CAG Agenda (May 2006)

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Written Representations—Proposed ISA 580 (Revised and Redrafted) – March 2006 IAASB Agenda Item 7-A

INTERNATIONAL STANDARD ON AUDITING 580 (REVISED)

WRITTEN REPRESENTATIONS

(Effective for audits of financial statements for periods

beginning on or after xx December, 200x)

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International Standard on Auditing (ISA) 580 (Revised), “Written Representations” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services,” which sets out the application and authority of ISAs.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s responsibility to obtain written representations, the procedures to be applied in evaluating and documenting such representations, and the action to be taken if the auditor is unable to obtain appropriate written representations.

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after xx xx, 20xx.

Objective to be Achieved

3. In relation to this ISA, the objective of the auditor is:
 - (a) To obtain from relevant persons:
 - (i) Written confirmation of their understanding of their responsibility and accountability for the preparation and presentation of the financial statements and assertions therein; and
 - (ii) Written corroboration of the accuracy and completeness of assertions in the financial statements, and of information provided to the auditor.
 - (b) To evaluate the adequacy of representations and determine the implications of any inadequacies for the audit and the auditor’s report.

Definitions

4. The following terms are introduced in this ISA:
 - (a) Written representations - Written statements provided by relevant persons from within the entity to the auditor at the auditor’s request. Written representations are either general written representations or specific written representations.
 - (b) General written representations - Written statements by relevant persons documenting their understanding of their responsibility and accountability for the preparation and presentation of the financial statements, and assertions therein.
 - (c) Specific written representations - Written responses from relevant persons to inquiries by the auditor, documenting evidence in relation to assertions embodied in the financial statements.

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- (d) Relevant persons – Individuals responsible and accountable for the preparation and presentation of the financial statements and assertions therein. Ordinarily, management is the responsible party and is accountable for the preparation and presentation of the financial statements, but there may be circumstances where, in addition, other individuals or bodies, such as those charged with governance, are also responsible and accountable. For specific written representations, relevant persons may also include persons with expertise pertaining to specific assertions.

Written Representations in the Context of an Audit of Financial Statements

5. Written representations in the context of this ISA do not include financial statements, the assertions therein, and supporting books and records.
6. The act of providing written representations by relevant persons reinforces the importance of their role in the preparation of the financial statements and improves clarity of communications. Further, the act of signing the written representations letter provides evidence of the consideration by relevant persons of important matters. A general written representations letter brings to the attention of, and reinforces, relevant persons' responsibilities in relation to the financial statements and often elicits thoughtful consideration of specific issues.

General Written Representations

7. The acknowledgement by relevant persons' of their responsibility and accountability for the preparation and presentation of the financial statements, assertions therein, and books and records is necessary to obtain sufficient appropriate audit evidence. In the absence of such acknowledgement, the auditor would have no confirmation that management accepts responsibility and accountability in the context of the auditor conducting the audit. Therefore, general written representations to the auditor are a prerequisite of audit completion.
8. Even though legislation, financial reporting framework or custom may establish relevant persons' responsibility and accountability for the preparation and presentation of the financial statements and assertions therein, this may not be in a complete or consistent manner from jurisdiction to jurisdiction. Irrespective of such establishment of responsibility and accountability, an explicit acknowledgement by relevant persons is appropriate in this context.
9. Further, general written representations relate to the financial statements taken as a whole and often are linked to the knowledge held by, and intentions known only to, relevant persons. Because such relevant persons' knowledge and intentions are not always manifest in a verifiable manner, general written representations are necessary to obtain sufficient appropriate audit evidence in relation to such knowledge and intentions. However, general written representations do not provide sufficient appropriate audit evidence by themselves.

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Specific Written Representations

10. In addition, audit evidence in the form of responses to inquiries directed at relevant persons may be an important part of the auditor's procedures. These responses may be documented in the auditor's working papers, where appropriate ("specific written representations"). In some cases, the auditor obtains audit evidence but concludes that, in addition, a specific written representation is necessary to obtain sufficient appropriate audit evidence.

Requirements

Relevant Persons

11. The auditor shall determine the relevant persons who are expected to provide general and specific written representations. (Ref: Para. A1 – A2)

Expectation about the Receipt of Written Representations

12. Unless law or regulation requires that the auditor accept the engagement, the auditor shall obtain an agreement from management and those charged with governance prior to the acceptance of the audit engagement that appropriate general written representations from relevant persons are necessary to obtain sufficient appropriate audit evidence. The auditor shall also advise management and those charged with governance that appropriate specific written representations may be necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A3)

General Written Representations

13. The auditor shall obtain a representation letter from relevant persons covering all periods presented, including the following:

Financial Statements

- (a) They acknowledge their responsibility and accountability for the preparation and presentation of financial statements that are free of material misstatement and in accordance with the financial reporting framework;
- (b) They acknowledge their responsibility for the design and implementation of internal control to prepare financial statements in accordance with the applicable financial reporting framework.
- (c) They believe the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements. A list of uncorrected misstatements shall be included in or attached to the written representation.

Further, the auditor shall obtain written representations from relevant persons that, to the best of their knowledge and belief:

- (d) All events subsequent to period end for which the financial reporting framework

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requires adjustment or disclosure have been adjusted and disclosed;

Completeness of Information

- (e) All records, documentation and other information relevant to the audit have been made available to the auditor.

Recognition, Measurement, and Disclosure

- (f) All plans or intentions that may materially alter the carrying value or classification of assets and liabilities in the financial statements have been disclosed in accordance with the financial reporting framework;
- (g) All liabilities, both actual and contingent, have been recorded and, where appropriate, disclosed, in accordance with the financial reporting framework;
- (h) The entity has satisfactory title to, or control over, all assets disclosed in the financial statements, and where appropriate, all liens or encumbrances on these assets have been disclosed, in accordance with the financial reporting framework; and,
- (i) The entity has complied with all aspects of contractual agreements that could have a material effect on the financial statements, or, in the event of non-compliance, has disclosed these aspects as required by the financial reporting framework.

Standards and guidance in other International Standards on Auditing (ISAs) may require the auditor to obtain additional general written representations. (Ref: Para. A4 – A7)

Specific Written Representations

- 14. Where the auditor determines that a specific written representation is necessary to obtain sufficient appropriate audit evidence, particularly in relation to matters involving judgment or intent, the auditor shall obtain such representation. A specific written representation is not sufficient appropriate audit evidence by itself. (Ref: Para. A8-A10)
- 15. Where specific written representations were obtained during the audit and dated earlier than the date of the auditor's report, the auditor shall consider whether it is necessary to obtain updated specific written representations.

Inadequate Written Representations

Written Representations Inconsistent with Other Evidence

- 16. Where a written representation is inconsistent with other audit evidence, the auditor shall evaluate the circumstances and determine what other audit procedures, if any, are necessary to evaluate the reliability of the written representation. Where the auditor performs such additional audit procedures and the results of those procedures cast further doubt upon the reliability of the written representation, the auditor shall reconsider the reliability of other written representations obtained.

Weaknesses Related to Competence, Integrity and Due Care

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17. Where the auditor has determined that weaknesses exist in management's competence, integrity or due care, the auditor shall assess the effect of such weaknesses on the reliability of written representations. (Ref: Para. A11)
18. Where the auditor concludes that a written representation is reliable audit evidence, irrespective of an identified weakness in management's competence, integrity or due care, the auditor shall document the reasons therefor.

Inability to Obtain Written Representations

19. If the auditor is unable to obtain a general written representation, this constitutes a scope limitation and the auditor shall express a disclaimer of opinion or consider withdrawing from the engagement.
20. If the auditor is unable to obtain a specific written representation that the auditor considers necessary in order to obtain sufficient appropriate audit evidence, this constitutes a scope limitation and the auditor shall evaluate the effect thereof on the auditor's report. (Ref: Para. A12-A13)

Application Material

Relevant Persons (Ref: Para. 11)

- A1. To establish who the relevant persons for general representations are, the governance structure of the entity, the relevant legislation and circumstances of the engagement are important. Relevant persons include the entity's chief executive officer and chief financial officer. Where uncertainty exists as to the identity of relevant persons, it may be necessary for the auditor to agree with the engaging party, prior to the engagement acceptance, who the relevant persons are.
- A2. For the purposes of specific written representations, determination of the relevant persons is a matter of professional judgment. In some circumstances, the auditor may conclude that the person responsible and accountable for the assertion is not the person knowledgeable about the assertion. In such cases, in addition to the signature of the responsible and accountable person, the signature of the person with expertise pertaining to the assertion may be necessary.

Expectation about the Receipt of Written Representations (Ref: Para. 12)

- A3. To ensure that management and those charged with governance are cognizant that written representations are an integral part of the audit, the auditor may wish to include in the audit engagement letter the auditor's expectation of receiving from relevant persons general and specific written representations. Where management declines to agree to provide general written representations, the auditor may need to consider not accepting the audit engagement. In some cases, law or regulation prevents the auditor from not accepting an engagement. In such circumstances, the auditor may need to explain to

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management and those charged with governance the importance of an agreement to provide written representations.

General Written Representations (Ref: Para. 13)

- A4. Audit evidence obtained by the auditor throughout the audit provides support for the matters included in general written representations. Such support, however, is not sufficient without obtaining general written representations from relevant persons.
- A5. General written representations are addressed to the auditor. Because the auditor dates the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements, it is appropriate that general written representation be as of the same date as the auditor's report.
- A6. The list of ISAs including requirements and guidance in relation to written representations is attached as Appendix 2.

Public Sector Considerations

- A7. The objectives of an audit of public sector entities, legislation or circumstances may give rise to the need for additional general written representations. These may include the following:
- General written representations acknowledging economy, efficiency and effectiveness of programs, projects and other activities.
 - General written representations on the existence of the internal audit function, appropriate for the size of the entity and its activities.

Specific Written Representations (Ref: Para. 14 - 15)

- A8. A specific written representation may become particularly relevant where the auditor performs audit procedures on matters involving relevant persons' judgment or intent. When evaluating relevant persons' judgments and intentions the auditor may consider one or more of the following:
- Entity's past history in carrying out its stated intentions.
 - Entity's reasons for choosing a particular course of action.
 - Entity's ability to pursue a specific course of action.
 - The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.
 - Combination thereof.

However, sufficient appropriate audit evidence in relation to relevant persons' judgments and intentions cannot be obtained without confirming with relevant persons what their intentions are.

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- A9. The auditor recognizes that the reliability of a specific written representation is influenced by its source and by its nature. Because the source is not independent, a specific written representation does not provide sufficient appropriate audit evidence by itself. For example, a written response to a specific inquiry in relation to the cost of an asset is not a substitute for the audit evidence of such cost that the auditor would ordinarily expect to obtain. In some circumstances, such as valuation of investments where management's intent is crucial to the accounting treatment, sufficient appropriate audit evidence cannot be obtained without obtaining from management a specific written representation in relation to their intentions.
- A10. Where the auditor determines that a specific written representation is necessary to obtain sufficient appropriate audit evidence, such written representation is dated as of the date it was obtained by the auditor. However, in the course of performing other audit procedures, the auditor may conclude that an event may have occurred between the date a specific written representation was obtained and the date of the auditor's report which may affect the assertion. In such circumstances, the auditor may conclude that the specific written representation needs to be updated. For example, where the auditor has obtained a specific written representation in relation to inventory obsolescence dated earlier than the auditor's report and subsequent events provide audit evidence casting doubt on the validity of the original response, the auditor may conclude that the representation be updated by relevant persons as of the date of the auditor's report.

Inadequate Written Representations

Competence, Integrity and Due Care (Ref: Para. 17 - 18)

- A11. ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" requires that the auditor obtain an understanding of the control environment. Elements comprising control environment include commitment to competence, communication and enforcement of integrity and due care. Where material weaknesses exist in relation to management integrity, competence and due care, this may affect the reliability of general and specific written representations. Where the effect is such as to undermine the reliability of general written representations, this gives rise to a scope limitation and the requirements and guidance in proposed ISA 705, "Modifications to the Opinion in the Independent Auditor's Report" are applicable. Where the auditor has determined that weaknesses exist in relation to the elements of management integrity, competence and due care, specific written representations may not provide reliable audit evidence.

Inability to Obtain Representations (Ref: Para. 19 - 20)

- A12. When relevant persons decline to provide general written representations, this implies unwillingness to acknowledge responsibility and accountability for the financial statements. The effect of such scope limitation is so material and pervasive that the auditor is unable to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. In some circumstances, the auditor may

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conclude that withdrawal from the audit engagement is appropriate. In other circumstances, the withdrawal may not be possible and a disclaimer of opinion may be necessary.

A13. Where the auditor is unable to obtain sufficient appropriate audit evidence because a relevant person declines to provide a specific written representation, such refusal results in a scope limitation and ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report” applies. Whether a modified opinion or a disclaimer of opinion is appropriate depends on how material and pervasive the effect that the inability to obtain specific written representations has on the audit evidence supporting the financial statements.

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Appendix 1

Example of a General Written Representations Letter

The following letter includes general written representations required by this and other ISAs. Although the inclusion of specific written representations on a variety of matters may serve to focus relevant persons' attention on those matters, and thus cause the relevant persons to specifically address those matters in more detail than would otherwise be the case, the auditor needs to be cognizant of the limitations of specific written representations as audit evidence as set out in this ISA.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of (present fairly, in all material respects) the financial position of ABC Company as of December 31, 20XX and of the results of its operations and its cash flows for the year then ended in accordance with (indicate relevant financial reporting framework).

Financial Statements

- We acknowledge our responsibility and accountability for the preparation and presentation of the financial statements in accordance with (relevant financial framework).
- We acknowledge our responsibility for the design and implementation of internal control to achieve the entity's objective with regard to financial reporting, including the design and implementation of internal control to prevent and detect fraud or error.
- We believe the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements. A list of uncorrected misstatements is attached.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- We have disclosed to you all information in relation to fraud or suspected fraud affecting the entity involving:
 - (i) Management;
 - (ii) Employees who have significant roles in internal control; or
 - (iii) Others where the fraud could have a material effect on the financial statements; and

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- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
- We have disclosed to you all known actual or possible noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
- We believe that all significant assumptions in relation to fair value measurements and disclosures are reasonable and appropriately reflect our intent and ability to carry out specific courses of action on behalf of the entity.
- We believe the measurement methods, including related assumptions, used by us in determining fair values within the applicable financial reporting framework, and the consistency in application of the methods are appropriate.

We confirm, to the best of our knowledge and belief, that

- The financial statements are free of material misstatement and in accordance with the financial reporting framework
- All events subsequent to period end for which the financial reporting framework requires adjustment or disclosure have been identified.

Completeness of Information

- We have provided to you all records, documentation and other information relevant to the audit.

Recognition, Measurement and Disclosure

- All plans or intentions that may materially alter the carrying value or classification of assets and liabilities in the financial statements have been disclosed in accordance with the financial reporting framework.
- All liabilities, both actual and contingent, have been recorded, and where appropriate, disclosed, in accordance with the financial reporting framework.
- The entity has satisfactory title to, or control over, all assets disclosed in the financial statements, and where appropriate, all liens or encumbrances on these assets have been disclosed, in accordance with the financial reporting framework.
- We have complied with the aspects of contractual agreements that could have a material effect on the financial statements and instances of non-compliance have been disclosed as required by the financial reporting framework.
- All transactions have been properly recorded and all disclosures properly made in accordance with the financial reporting framework.
- All events and matters for which the financial reporting framework requires restatement of the comparative financial statements have been identified.

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- The information provided regarding the identification of related parties, as defined by the financial reporting framework, is complete.
- The related party disclosures in the financial statements are in accordance with the requirements of the financial reporting framework.

(Relevant Person)

(Relevant Person)

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Appendix 2

List of ISAs Containing Written Representation Requirements

Draft ISA 240 (Redrafted) “The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statement” – paragraph 31.

ISA 250 “Consideration of Laws and Regulations” – paragraph 23.

ISA 545 “Auditing Fair Value Measurements and Disclosures” – paragraphs 63 – 64.

Proposed ISA 550 (Revised) “Related Parties” – paragraph 49.

ISA 570 “Going Concern” – paragraph 26c.

Proposed ISA 540 (Revised) “Auditing Accounting Estimates and Related Disclosures (Other than Those Involving Fair Value Measurements and Disclosures)” – paragraph 95.