



ISA 580 WRITTEN REPRESENTATIONS

Proposed revised and redrafted International Standard on Auditing issued for comment by the International Auditing and Assurance Standards Board of the International Federation of Accountants

Comments from ACCA
April 2007



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Executive Summary

ACCA welcomes the opportunity to comment on the proposed International Standard on Auditing ISA 580 (Revised and Redrafted) *Written Representations* (proposed ISA 580), issued for comment by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants.

We have serious concerns over two of the proposed requirements.

We do not agree with a requirement under which relevant parties are to represent whether they believe that the internal control they have maintained is adequate. It is not the place of auditing standards to require management to issue an opinion on the effectiveness of internal control.

Where general representations are not received, we do not agree that auditors should be forced to issue a disclaimer of opinion where their professional judgement is that a disclaimer is not appropriate.

The Appendix to this response provides further information on the deficiencies that we identify in the requirements of this and other proposed ISAs resulting from the Clarity project.

Matters on which Specific Questions are Asked

In this section of our response we address the issues identified for specific comment in the Explanatory Memorandum forming part of the Exposure Draft.

GENERAL WRITTEN REPRESENTATIONS REGARDING THE FINANCIAL STATEMENTS

We do not agree with the inclusion of the third bullet point of paragraph 8, which requires relevant parties to state whether specific matters, where relevant in view of the applicable financial reporting framework, have been recognised, measured or disclosed in accordance with that framework.

The subbullets address matters that are either implicit in the financial reporting framework (eg liabilities) or are aspects on which specific representation should be sought if necessary (eg plans or intentions).

Because of this, we agree with the views of some IAASB members that the subbullets should be moved to the Application and Other Explanatory Material (A&OEM) section.

GENERAL WRITTEN REPRESENTATIONS REGARDING INTERNAL CONTROL

We accept that it is appropriate to request confirmation of responsibility for internal control, but we do not agree with the further wording in paragraph 9 of proposed ISA 580 requesting relevant parties to represent whether they believe that the internal control they have maintained is adequate for that purpose.

This amounts to an opinion on the effectiveness of internal control relevant to the preparation of the financial statements. It is not the place of auditing standards to seek to impose such a requirement in the absence of specific legislation or other regulation applying to the audited entity.

The Explanatory Memorandum makes the point that the requirement in paragraph 6 of proposed ISA 580 refers to representations *'based on relevant parties' knowledge and belief, having made appropriate inquiries for them to be able to provide such representations'*. The Memorandum also explains that *'It is not envisaged that such inquiries will entail a comprehensive assessment of the effectiveness of internal control.'*

We do not believe that either of these statements justifies the wording as proposed. The Explanatory Memorandum cannot interpret a requirement in the finalised ISA, as that must stand alone. Paragraph 9 itself must contain this stipulation as the construction of ISAs in the Clarity project does not allow for requirements to be combined in this way. The wording in paragraph 6 is actually explanatory material and, as ACCA has argued at length in previous responses, its inclusion in the requirements section in this way invites confusion.

We suggest that an appropriate general representation would be confined to those responsible for internal control relevant to the preparation of the financial statements. They should be asked to confirm that they continue to accept that responsibility and that nothing has come to their attention that would cause them to believe that the internal control is not adequate for that purpose.

A negatively worded representation, together with suitable material in the A&OEM section is less likely to be misinterpreted.

DISCLAIMER OF OPINION WHEN GENERAL WRITTEN REPRESENTATIONS ARE NOT OBTAINED

As explained earlier in this response, we do not agree with the general written representations about the premises on which an audit is conducted set out in paragraphs 8 to 10 of proposed ISA 580. Even if the premises were correct, relating to management's responsibilities, we can envisage circumstances where management may be unable to provide such representations.

There is a danger that mandating a disclaimer for a deficiency in general representations will discourage the consideration of a disclaimer for deficiencies in specific representations, however material and pervasive.

We do not support the introduction, therefore, of a rule that would force auditors to disclaim an opinion in circumstances where their professional judgement is that a disclaimer is not appropriate.

Paragraph 14 is entirely explanatory. We suggest that the material comprising paragraphs 14 to 20 should mainly appear in the A&OEM section and the essential requirements should be restated in relation to two conditions precedent:

- (1) If the relevant parties do not provide one or more requested representations
- (2) If the auditor is aware of significant evidence conflicting with representations received, or if the auditor has identified significant issues related to management's commitment to competence, communication and enforcement of integrity and ethical values, or diligence

DATE OF THE WRITTEN REPRESENTATIONS

We accept that the general written representations should be as of the same date as the auditor's report on the financial statements. There are practical reasons, however, why this may not always be possible. We suggest that the requirements in proposed ISA 580 should be aligned with those in ISA 560 *Subsequent Events*, so that the requirement is worded in terms of '*as near as practicable to the date of the auditor's report*'.

OBJECTIVE AND REQUIREMENTS

Objective

While overall we consider that the objective is appropriate, we have some difficulties with the detail of its wording.

The use of the word ‘corroborate’ is open to misinterpretation as all audit evidence either corroborates or contradicts in the wider sense. The requirements include investigation of inconsistencies with other audit evidence, which supports the view that the written representation stands alone as audit evidence and is not merely corroborating (in the sense of supporting) other evidence.

The two parts of the objective are written differently: part (a) refers to (corroborating) the validity of premises but part (b) omits the concept of validity and refers only to (corroborating) audit evidence obtained.

The term ‘audit evidence obtained’ is used. We are unsure why part (b) could not refer to ‘Other audit evidence’ as that adequately distinguishes it from (a).

Requirements

Question 5 in the Explanatory Memorandum asks whether the requirements are an appropriate response to the objective.

We have commented elsewhere in this response on several of the requirements.

Our overall impression of proposed ISA 580 is that the document is too detailed and too procedural and as a result will impose costs for little commensurate benefit.

For example, the requirement to determine relevant parties to provide representations is unnecessary. It is, in essence, explanatory material that has been rewritten as a requirement to give it prominence.

Clearly the auditor will ask some party to provide a representation and the identity of that party is a factor that is relevant to judging its reliability. A requirement to evaluate the representation implicitly includes consideration of the party that gives it. To require separately determination of relevant parties to provide representations is duplication. Indeed, by presenting the requirement in this way it may deter auditors from exercising sufficient professional scepticism once they have made their requests.

Paragraph 11 requires that the general written representations are in the form of ‘a **representation** letter addressed to the auditor’[emphasis added].¹

Extant ISA 580 explains that a written representation can take the form of a representation letter, confirmation by management or agreement to a letter from the auditors, or signed minutes such as of the board of directors.

We do not agree with restricting the form of written representations to a ‘representation letter’, when other forms are equivalent. As other forms of written representation are common in the audit of smaller entities, the change will impose disproportionate costs for no valid reason.

It is not the place of ISAs to impose requirements on management. While auditors may request written representations in a particular form it is for management to decide how that should be provided. If management wishes to provide representation in an alternative form it will not be in the public interest that auditors are forced to reject them and issue a disclaimer of opinion.

Such an event could bring ISAs into disrepute and we cannot stress more strongly the need to change this requirement to avoid that eventuality.

The Appendix to this response provides further information on the deficiencies that we identify in the requirements of this and other proposed ISAs resulting from the Clarity project.

OTHER MATTERS

The Explanatory Memorandum forming part of the Exposure Draft invites comments on the following other matters:

- Special considerations in the audit of small entities
- Special considerations in the audit of public sector entities
- Developing nations
- Translations

¹ Clearly the word ‘representation’ is unnecessary as a letter containing general representations is by definition a ‘representation letter’.

We have noted elsewhere in this response that certain proposals will increase costs. Such increases have a disproportionate impact on the audit of small entities, the number of which are often significant in developing nations.

We agree with the material introduced for the audit of public sector entities.

The word 'premises' has two common meanings: a proposition or land and buildings. The former has legal connotations while the latter should cause little confusion if constructions such as 'the premises on which an audit is carried out' are avoided. Translators may benefit from clarification that the word is not used with legal intent.

Appendix: Common Deficiencies in Requirements

This Appendix provides further information on the deficiencies that we identify in the requirements of this and other proposed ISAs issued as part of the Clarity project.

GROWTH IN NUMBER OF REQUIREMENTS

There seems to be no external economic or social justification, suddenly to increase the degree of specificity of ISAs; nevertheless, many proposed ISAs exhibit a substantial growth in the number and detail of specific requirements. We are not convinced that the guidelines adopted for deciding on the requirements to be included in an ISA are correct.

We are concerned that the proliferation of requirements will promote a ‘tick-box’ mentality. Each extra requirement introduced is another box to tick, another factor that can reduce the quality of an audit, and another cost that bears disproportionately on smaller audits and deters the more widespread application of ISAs.

Our detailed analysis concludes that hardly any of the changes from a present-tense statement to a requirement are justified. We recommend that the proposed requirements be reconsidered on an individual basis and that each remains as a requirement only if a strong case can be made for that.

The ‘requirement’ is really guidance on another requirement

Many new requirements deal with the same subject as another but in greater detail: the auditor is required both to do something and also to carry out the steps in that process. This is a simple duplication, which should be eliminated.

In some instances, the secondary requirements illustrate how the primary requirement is met in circumstances that will be relatively rare, giving rise to complex prose.

Such secondary requirements are best treated as explanatory material that auditors can refer to in relation to the primary requirement.

DRAFTING OF REQUIREMENTS

We do not find the requirements sections of proposed ISAs easy to understand. There are three main reasons for this:

- explanatory material is interspersed with the requirements,
- the wording of requirements makes no distinction between basic principles and essential procedures, and
- the requirements are not constructed in a simple fashion.

Explanatory material

We do not support splitting the supplementary material providing explanation and guidance between the Application and Other Explanatory Material (A&OEM) section and the requirements section. Such an approach forces users to carry out a detailed analysis of the text of the requirements section to identify the 'essential explanatory material' and discover which parts of the text are actual requirements. Rather than improving clarity, explanatory material adds unnecessary length and detracts from the reader's understanding. Instead, we strongly suggest that the 'essential explanatory material' and the 'supplementary material providing further explanation and guidance' both be presented only in the A&OEM) section (or its appendices).

Basic principles and essential procedures

The bold type in extant ISAs identifies basic principles and essential procedures. These are substantially different in nature, but the Clarity project has combined the two as 'requirements'. We do not agree with this approach, which leads to confusion, as auditors may attempt to treat a principle as an action, or vice versa.

The corresponding and perhaps greater danger is that auditors who correctly interpret some of the 'shall' statements as principles will treat as principles some that are intended as active requirements. We recommend separating the principles with which the auditor is required to comply from the required procedures and other actions.

Simple construction

We do not find the requirements easy to understand because they are not always drafted in a simple fashion. Requirements with multiple conditions precedent are particularly difficult to understand when written in prose. The complexity of the material also makes translation difficult.

Auditors who need to know when a requirement applies, and when it does not, have to be very diligent and analytic readers. We recommend rewording all requirements so that there is no doubt about the meaning of the various 'shall' statements. This should be done using a structure that clearly shows:

- any conditions precedent
- on whom the requirement is placed
- the action required, and
- the object of that action.

An example of such an structure was include as an Appendix to our February 2006 response to the redrafting proposals 'Improving the Clarity of IAASB Standards'.

TECH-CDR-646.DOC

The Association of Chartered Certified Accountants

29 Lincoln's Inn Fields London WC2A 3EE United Kingdom

tel: +44 (0)20 7059 7000 fax: +44 (0)20 7059 7070 www.accaglobal.com