

**ISA 580 Management Representations
Task Force Proposals****INTRODUCTION**

1. At its meeting in Toronto in April 2004, the IAASB approved a project proposal to revise ISA 580, "Management Representations" (the "Standard"). The need to revise the Standard arose in the wake of several accounting scandals where the auditor's overreliance on certain management representations may have been a contributing factor to the audit failure. As a result, there was a need to understand why auditors obtain management representations and what the value of management representations as audit evidence is. The assessment of the value of management representations leads to questions of what evidence a management representation provides and who should provide it. The form of management representations has become important due to cultural specifics of some countries where obtaining a formal letter may be difficult. Finally, it is important that application of the Standard be consistent across jurisdictions so that management representations do not vary from country to country. To accomplish consistency and introduce greater rigor, it is necessary to consider which management representations the auditor should always obtain.

PROJECT HISTORY

2. Following the approval of the proposal, a Task Force was formed to address the issues and revise the extant Standard. The Task Force held conference call meetings in November 2004 and January 2005 and met in January and April 2005. The Task Force submitted a first Issues Paper to the IAASB in March 2005. The Task Force proposed a change in the auditor's approach to management representations. The IAASB requested that the Task Force revisit the discussion of the proposed new approach to demonstrate the advantages. In addition, the IAASB requested the Task Force to demonstrate how this approach would be translated into standards and guidance.

PROPOSED REQUIREMENTS AND REASONING

3. This document presents requirements proposed by the Task Force and the reasoning for the requirements. The proposed requirements are based on the conclusions of the Issues Paper presented to the IAASB in Lima. The conclusions were summarized as follows:

"Management representations differ from other audit evidence in that they may involve transactions or events that have a significant impact on the financial statements and yet corroborative evidence may not always be available. The Task Force noted that the scope of representations has been steadily increasing in recent years. This trend has affected the content, length and complexity of national standards and of management representations letters.

The Task Force concluded that certain representations, specifically those relating to the financial statements, are different. These representations, by providing evidence of management's acceptance of responsibility and accountability for the financial statements,

become a condition of auditability. Due to its nature, this condition cannot be met by other evidence. This fact separates these “general” representations from assertion-specific representations. Additional evidence ordinarily exists for assertion-specific representations. Therefore, the Task Force decided to adopt a distinct approach to management representations.

4. The glossary defines management representation as “representations made by management to the auditor during the course of the audit, either unsolicited or in response to specific inquiries.” This paper proposes that “management representations” be considered in terms of “general management representations” and “written responses to inquiries”. The Task Force proposes the following definitions for these terms.

Proposed Definitions

General management representations are written statements by relevant persons documenting management’s acceptance of responsibility and accountability for the preparation and presentation of the financial statements.

Specific management representations (“written responses to inquiries”) are written responses from relevant persons to inquiries documenting evidence in relation to assertions embodied in the financial statements.

Why Does the Auditor Obtain Management Representations (General Management Representations and Written Responses to Inquiries)?

Background Information:

5. Management should maintain appropriate and complete documentation to support their financial statements. Accordingly written representations to the auditor and written responses to inquiries for the auditor should not take the place of documentation the management should have in their books and records to support their financial statements.
6. The auditor is required to obtain sufficient appropriate audit evidence on which to base the opinion. With respect to certain matters such as management’s acknowledgement of their responsibility and accountability for the preparation and presentation of the financial statements the auditor cannot obtain sufficient audit evidence without written representations from management. Although such matters may be stated in law or implied by management signing the financial statements, such evidence is not a direct, documented acknowledgement of responsibility and accountability made specifically to the auditor. The same reasoning may apply to written responses to inquiries about specific matters such as management’s intent about a matter that is necessary to determine the appropriate accounting. Although there will be evidence supporting management’s intent, the auditor cannot have sufficient evidence about intent without asking management what their intent is. The rigor imposed by making written signed statements focuses the management’s mind on the importance of the statements and the need for clarity and completeness in a way no implied or oral response is likely to achieve. Accordingly the standard should require the auditor to obtain written representations for certain matters, and such written responses to

inquiries, that the auditor judges to be necessary to obtain sufficient appropriate audit evidence about particular matters.

7. To help avoid misunderstanding, prior to commencing the engagement, the auditor should communicate those written management representations that the auditor expects to receive, and clarify that responses to inquiries may be necessary. The auditor may wish to specify the expected individual representations in the engagement letter. The auditor may also wish to include an explanation of the purpose of management representations and responses to inquiries, the relevant persons expected to provide these written representations and responses to inquiries, and the implications of refusal to provide these written representations or responses to inquiries.

Proposed Requirement:

The auditor should advise management prior to the commencement of the audit that appropriate written representations from relevant persons are necessary to obtain sufficient appropriate audit evidence and are, therefore, a prerequisite for the issuance of an audit opinion. The auditor should also advise management that appropriate written responses to inquiries may be necessary to obtain sufficient appropriate audit evidence.

Extant Standard Requirement:

Not addressed in the extant ISA 580

Relation to Objectives of Revision

Inclusion in the terms of engagement of the expectation to receive management representations and written responses to inquiries will enhance the rigor of the Standard and improve the consistency of application by making clear the auditor's expectations and requirements for completing the engagement.

What Management Representations Should the Auditor Obtain?

Background Information:

8. In the process of preparing the financial statements, management makes certain implicit statements about its responsibilities and about assertions made in the financial statements. Acceptance of these responsibilities by management is a prerequisite for successful audit completion. Therefore, the auditor needs to obtain explicit statements in relation to these fundamental responsibilities. Management's general responsibilities often do not differ from audit to audit and the auditor obtains such statements (management representations) confirming management's acceptance of these on every audit engagement. In addition, a clear statement on the responsibilities of management also focuses management's attention on their relevant responsibilities.
9. Furthermore, other ISAs require that management provide certain written representations. For example, ISA 250, "Consideration of Laws and Regulations in An Audit of Financial Statements, states in paragraph 23, "The auditor should obtain written representations that

management has disclosed to the auditor all known actual or possible noncompliance with laws and regulations whose effects should be considered when preparing financial statements.”

Proposed Requirement:

The auditor should obtain audit evidence that management acknowledges its responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. In particular, the auditor should obtain written representations from relevant persons that:

- (a) **Management acknowledges its responsibility and accountability for the financial statements;**
- (b) **Management acknowledges its responsibility for the design and implementation of internal control to achieve the entity’s objective with regard to financial reporting;**
- (c) **Management believes the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements. A summary of such items should be included in or attached to the written representation.**
- (d) **Management has provided the auditor with records, documentation and other information requested in connection with or material to the audit.**
- (e) **All transactions have been properly recorded and all disclosures properly made in accordance with the financial reporting framework;**
- (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) **The financial statements are free of material misstatement and in accordance with the financial reporting framework;**
- (h) **All liabilities, both actual and contingent, have been recorded and, where appropriate, disclosed in accordance with the financial reporting framework;**
- (i) **The entity has satisfactory title to 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;**
- (j) **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 as required by the financial reporting framework;**
- (k) **All events subsequent to period end for which the financial reporting framework requires adjustment or disclosure have been identified; and,**
- (l) **All events and matters for which the financial reporting framework requires restatement of the comparative financial statements have been identified.**

Extant Standard Requirements:

The auditor should obtain appropriate representations from management.

The auditor should obtain audit evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with the applicable financial reporting framework, and has approved the financial statements.

The auditor should obtain written representation from management that:

- (a) It acknowledges its responsibility for the design and implementation of internal control to prevent and detect error; and
- (b) It believes the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representations.

Relation to Objectives of Revision

Inclusion of mandatory management representations in the Standard will enhance the rigor of the Standard and improve the consistency of application.

Written Responses to Inquiries*Background Information:*

- 10. In addition to general management representations, the auditor may need to obtain written responses to inquiries relating to certain specific financial statement assertions. ISA 500, "Audit Evidence" states in paragraph 2, "The auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion." Sufficient appropriate evidence is relevant, reliable (i.e. appropriate) and in appropriate quantity (sufficient). Relevance, reliability and quantity, however, depend on the auditor's judgment.
- 11. Ordinarily, the auditor is able to obtain sufficient appropriate audit evidence to reduce the risk of material misstatement to an acceptably low level without obtaining written responses to inquiries. In some circumstances, however, responses to inquiries are of particular significance to the audit and the auditor needs to have documentation of such responses in writing. This issue may arise, for example, when the auditor considers matters involving management judgment, intent, or facts and knowledge confined to management. In such circumstances, the auditor may determine that a written response to inquiry signed by the person or persons having both knowledge and responsibility for the presentation of the assertion is necessary. This written representation documents the response to an inquiry and is, therefore, audit evidence. In the event the response to an inquiry relates to a matter the auditor considers particularly significant, the auditor may decide to include the written response to inquiry in the management representation letter.
- 12. Whether a written response to an inquiry is necessary depends on the auditor's assessment of other available audit evidence, and will vary from audit to audit. Accordingly, it is not

practical to provide a list of all matters for which written responses to inquiries need to be obtained. Ordinarily, the auditor obtains a written response to inquiry where such response complements other auditing procedures to obtain sufficient appropriate evidence.

13. The auditor may determine an amount below which matters are not relevant for the purposes of management representations and written responses to inquiries. The amount may be applied to those representations not concerning responsibility and accountability for the financial statements and responsibility for the design and implementation of controls to prevent and detect fraud.

Proposed Requirement:

The auditor should consider whether written responses to certain inquiries are needed to obtain sufficient appropriate audit evidence.

Corroborative Evidence

Background Information:

14. Corroborative evidence is evidence that supports other audit evidence obtained. Written responses to inquiries relating to certain specific financial statement assertions corroborate other audit evidence; however, they do not provide sufficient appropriate audit evidence in themselves.
15. In the process of gathering sufficient appropriate audit evidence, the auditor may conclude that the existing audit evidence needs to be complemented by a response to an inquiry. In some countries, such communication may already exist internally under corporate governance or risk management practices of the entity. In such case, the auditor obtains a copy of the document for audit evidence purposes. Where such internal documentation does not exist, the auditor determines the relevant person and requests that the relevant person respond in writing to the auditor's inquiry. However, in these circumstances, the auditor may need to consider whether management should be made aware of the possible deficiency in its internal documentation to support the amounts and disclosures in the financial statements. Therefore, the response to the inquiry not only represents audit evidence, it also becomes additional documentation by management that becomes part of the entity's books and records supporting the amounts and disclosures in the financial statements.
16. Evidence may contradict or be inconsistent in some way with other evidence. In such cases the auditor considers these matters in reaching conclusions. Management representations or responses to inquiries also may be inconsistent with or contradicted by other evidence. In such cases the auditor obtains sufficient appropriate evidence on which to base the auditor's conclusion and considers the implications on the acceptability of the management representations or responses to inquiries. For example, the auditor obtains a written response to inquiry corroborating management's assertion that they intend to hold an investment to maturity. However, in the process of performing unrelated auditing procedures, the auditor may obtain evidence that the entity's circumstances will require

disposal of the asset prior to maturity. The auditor considers the effect of this additional audit evidence on the auditor's conclusions in relation to management intent.

Proposed Requirement:

If a written response to inquiry is inconsistent with other audit evidence, the auditor should investigate the circumstances and, when necessary, reconsider the reliability of other written responses obtained.

Extant Standard Requirement:

The auditor should obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist.

If a representation by management is contradicted by other audit evidence, the auditor should investigate the circumstances and, when necessary, reconsider the reliability of other representations made by management.

Relation to Objectives of Revision

The discussion and requirements in relation to written responses to inquiries address the nature of representations as audit evidence and the issues of undue reliance on representations and greater rigor.

Who Should Provide Management Representations and Written Responses to Inquiries?

Background Information:

17. Diversity of responsibility, and authority distribution in various countries makes it difficult to establish universal identification of the persons who should sign written representations provided to the auditor. Therefore, the auditor needs to determine who the persons responsible and accountable for the financial statements are. This may be specifically determined by law. In many countries, the ultimate responsibility rests with the chief executive officer and chief financial officer. In such case, the written representations acknowledging responsibility for the financial statements are signed by these officers. Because of the varying practice across jurisdictions, however, it is necessary to use a general term encompassing all responsible accountable persons in many countries. For this purpose, the auditor determines "relevant persons," as explained in ISA 260, "Communication of Audit Matters with Those Charged with Governance," paragraph 5.
18. Where the auditor needs to obtain written responses to inquiries relating to certain specific financial statement assertions to complement other auditing procedures, the auditor determines relevant persons for the purposes of the individual assertion. The auditor considers whether the person providing the written representation is knowledgeable about and responsible and accountable for the matter. In the event of delineation of knowledge and responsibility the auditor obtains signatures of both the knowledgeable and the responsible person.

Proposed Requirement:

The auditor should determine the relevant persons who are expected to provide management representations. Furthermore, for each written response to an inquiry, the auditor should also determine the relevant persons who are expected to provide that written response.

Extant Standard Requirement:

Not addressed in the extant ISA 580.

Relation to Objectives of Revision

This requirement addresses the objective of who should provide written representations and responses to inquiries

When Should the Auditor Obtain Management Representations?

Background Information:

19. ISA 700 requires that the auditor date and sign 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. Therefore, written representations confirming management responsibility and accountability for the financial statements for all periods covered by the auditor's report are dated as of the date of the auditor's report. In addition, the auditor is in position to sign the auditor's report only when all written representations have been received.
20. When the auditor establishes the need to obtain written responses to inquiries relating to certain specific financial statement assertions to complement auditing procedures, the auditor dates these responses as of the date of signing. When the auditor includes in audit evidence a written communication of responsibility generated for internal purposes by the entity to comply with corporate governance or risk management practices, the document is dated as of the date of inclusion in the audit evidence. The auditor considers whether matters covered in these written responses need updating before the auditor's report is issued. For example, in the course of the engagement the auditor obtains a written response to inquiry in relation to the intent to hold certain investments to maturity. Prior to the issue of the report, circumstances of the entity change as a result of unforeseeable events. The auditor updates the written response to ensure management intent has not been affected by the events.

Proposed Requirement:

The auditor should obtain a management representation letter signed by relevant persons and dated as of the date of the auditor's report. The auditor should consider updating of written responses to inquiries where updating the matter covered by the response may be relevant.

Extant Standard Requirement:

Not addressed in the extant ISA 580.

Relation to Objectives of Revision

This requirement addresses the objectives of greater rigor and consistent application.

Reliability of Management Representations*Background Information:*

21. ISA 500, "Audit Evidence" provides standards and guidance in relation to the reliability of audit evidence. The Standard recognizes two factors influencing reliability, the source of evidence and the nature of evidence. Since the sources of management representations and written responses to inquiries are relevant persons, the value of such representations and responses as audit evidence will directly depend on the competence and ethical values of and due care by management. Competence and integrity are a part of the control environment procedures addressed in Appendix 2 to ISA 330, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement." The result of risk procedures assessing competence and integrity has a direct relationship with the value of written representations as audit evidence. Where problems exist relating to competence or ethical values of management, the auditors assesses the effect of the weaknesses on the value of written representations.

Proposed Requirement:

When, in the course of obtaining an understanding of the control environment, the auditor has determined that weaknesses exist in management competence, integrity and due care, the auditor should assess the effect of the weaknesses on the reliability of management representations.

Extant Standard Requirement:

Not addressed in the extant ISA 580

Relation to Objectives of Revision

This requirement addresses undue reliance and introduces greater rigor into the Standard.

Refusal to Provide Management Representations or Written Responses to Inquiries*Background Information:*

22. Audit documentation includes evidence of management representations in the form of a written and signed management representation letter and, where appropriate, of written and signed responses to inquiries relating to specific financial statement assertions to complement other auditing procedures.
23. If the relevant persons refuse to provide written representations acknowledging responsibility and accountability for the financial statements by management, this constitutes a material and pervasive limitation of scope. In such circumstances, the auditor cannot obtain sufficient appropriate audit evidence and a disclaimer of opinion or

withdrawal from the engagement is appropriate.

24. If the relevant persons refuse to provide a written response to inquiry that the auditor considers necessary to complement auditing procedures, the auditor considers the effect of the refusal on other audit evidence and the auditor's report. The auditor makes a critical assessment of other audit evidence obtained and is alert to audit evidence that undermines the reliability of documents and responses to inquiries. The auditor also considers the effect on the auditor's conclusions in relation to integrity, competence and due care of management.
25. Ordinarily, the refusal constitutes a limitation on the scope of the audit and a modified opinion is appropriate. Where the nature of representations not obtained or the circumstances of the refusal warrant it, the auditor may conclude that the modified opinion may not be necessary.

Proposed Requirement:

If a relevant person refuses to provide a representation acknowledging responsibility and accountability for the financial statements, this constitutes a scope limitation and the auditor should express a disclaimer of opinion or withdraw from the engagement. If a relevant person refuses to provide a written response to inquiry which the auditor considers necessary in order to obtain sufficient appropriate audit evidence for that assertion, this constitutes a scope limitation and the auditor should determine the impact on the audit and the auditor's report.

Extant Standard Requirement:

If management refuses to provide a representation that the auditor considers necessary, this constitutes a scope limitation and the auditor should express a qualified opinion or a disclaimer of opinion.

Relation to Objectives of Revision

This requirement will result in greater rigor and consistent application of the Standard.