



**International Federation of Accountants**

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**Agenda Item**

**7**

**Committee:** IAASB  
**Meeting Location:** New York  
**Meeting Date:** October 25-27, 2006

**Written Representations**

**Objectives of Agenda Item**

To review and approve proposed ISA 580 (Revised and Redrafted), “Written Representations” for issue as an exposure draft.

**Task Force Members**

The members of the task force are:

John Fogarty (Chair)	IAASB Member
Josef Ferlings	IAASB Member (assisted by Wolfgang Böhm, IAASB Technical Advisor)
Vijaya Moorthy	INTOSAI Representative
Sylvia Smith	IAASB Technical Advisor

**Activities since Last IAASB Discussions**

At the July 2006 meeting, the task force presented a discussion paper addressing issues raised at the June 2006 CAG meeting. On balance, the IAASB members supported the task force’s approach and recommendations in relations to these issues. Additional issues were raised by some IAASB members. Further, CAG Representatives expressed additional concerns at its September 2006 meeting. These issues, and the task force’s proposed dispositions, are set out below.

**Issues and Recommended Dispositions Presented to the IAASB for Consideration**

**WRITTEN REPRESENTATIONS AS CORROBORATING EVIDENCE IN RELATION TO ASSUMPTIONS ABOUT MANAGEMENT ACTIVITIES AND BELIEFS**

Some IAASB members and CAG Representatives expressed concerns about the guidance relating to the value of written representations as audit evidence. These concerns included the following:

- The guidance should further elaborate on the notion that certain assumptions about management activities and beliefs are essential to the performance of an audit of financial statements and that the auditor has to confirm the continued appropriateness of those assumptions.
- It is also important to clarify what corroborates what – that is, is it the audit evidence obtained during the audit or the representation letter obtained at the end of the audit that corroborates the assumptions in the engagement letter?

- Written representation letters are necessary audit evidence but they are not sufficient audit evidence. This needs to be reflected in the ISA.
- Whether it was reasonable to issue a disclaimer of opinion in circumstances where, for example, lawyers change the wording of required representations, or where all general representations have been obtained except for one.

The task force discussed these issues and agreed that the notion of confirming assumptions about management activities and beliefs is the focal point of the ISA and needs to be adequately explained in ISA 580 and certain other ISAs. To achieve this, and to provide an appropriate setting for ISA 580, the task force has proposed a conforming amendment to ISA 200, “Objective and General Principles Governing An Audit of Financial Statements” (see Agenda Item 7-A, Proposed Conforming Amendments).

The amendment explains that the auditor accepts an audit on the basis that certain assumptions relating to management activities and beliefs essential to the performance of the audit have been met. These assumptions refer to management’s acknowledgement, understanding and fulfillment of its responsibilities in relation to:

- Preparing and presenting the financial statements in accordance with the applicable financial reporting framework;
- Designing, implementing and maintaining internal control over financial reporting; and
- Providing complete information to the auditor.

It is the view of the task force that the auditor cannot complete an audit without obtaining sufficient appropriate audit evidence that these assumptions are appropriate. Even though evidence relating to the assumptions is obtained in the terms of engagement and audit evidence obtained during the audit, sufficient appropriate audit evidence cannot be obtained without written representations confirming to the auditor that management has fulfilled its responsibilities in relation to the assumptions (see Agenda item 7-A, paragraph A3).

The task force agreed that written representations, whether general or specific, do not constitute sufficient appropriate audit evidence, and the ISA includes specific statements in this respect (see Agenda item 7-A, paragraphs 6 and 9).

The task force also agreed that the requirement to issue a disclaimer of opinion where relevant persons refuse to provide all required representations may result in unwarranted difficulties for the auditor and relevant persons in circumstances where a representation may not be fully applicable to the engagement. Accordingly, the task force inserted “whether” in front of the required representations to allow for some flexibility in the wording of the representations. Further, the task force drafted a new paragraph in the application material explaining that, “some general representations relating to the relevant persons’ responsibility for preparing and presenting the financial statements may not always be relevant.” (See Agenda item 7-A, paragraphs 6(a), (b), and (c) and A13) However, the task force remains of the view that where relevant persons refuse to provide written representations relating to the relevant persons’ fulfillment of the responsibility for (a) the design, implementation and maintenance of internal control, and (b) the completeness of information, the auditor cannot obtain sufficient appropriate audit evidence in relation to the assumptions essential to the performance of the audit. In these circumstances, the possible effects on the financial

statements of the inability are pervasive and, in accordance with ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report,” the auditor issues a disclaimer of opinion.

**Action Requested**

Does the IAASB agree with the task force’s conclusions on written representations as corroborating evidence in relation to the assumptions about management activities and beliefs?

**LINK BETWEEN TERMS OF ENGAGEMENT AND REPRESENTATION LETTER**

Some IAASB members and CAG Representatives were concerned about the link between ISA 210, “Terms of Audit Engagements” and ISA 580 in relation to the assumptions about management activities and beliefs essential to the performance of an audit. These concerns included the following:

- Whether the link between the terms of engagement and representation letter could be further explained.
- The representation letter is at best corroborating evidence of a series of understandings obtained during the audit. The requirements and guidance should reflect the process.
- Whether it would be beneficial to include the guidance on who should sign the representation letter in the terms of engagement, particularly in circumstances where the terms of engagement is signed by the audit committee on behalf of the board of directors and representations by relevant persons.
- Inconsistency in the assumptions stated in the terms of engagement and the representation letter should be brought to the attention of those charged with governance.

The task force agreed that further clarification of the link between the terms of engagement and the representation letter would be helpful. The task force is further of the view that, in this context, there is a difference between the terms of engagement and the representations letter. That is, in the terms of engagement the auditor and relevant persons identify and agree what the assumptions about management activities and beliefs are, while in the representation letter relevant persons confirm that they have fulfilled their responsibilities in relation to the assumptions.

The task force redrafted the ISA to include a specific reference to the terms of engagement (see Agenda item 7-A, paragraph A4). Further, the task force has proposed a conforming amendment to ISA 210 (see Agenda item 7-A, Proposed Conforming Amendments). The amendment requires the auditor and management to identify and agree on the assumptions essential to the performance of an audit.

The task force agreed that the representation letter is corroborating evidence. The task force is further of the view that obtaining the representation letter is the culmination of a process started by agreeing with relevant persons on the assumptions about management activities and beliefs and further continued by obtaining understandings throughout the audit. This has been reflected in the ISA (see Agenda Item 7-A, paragraphs A3 and A4).

The task force is of the view that the proposed conforming amendment also addresses the issue of guidance in ISA 210 as to who should sign the representation letter where the terms of engagement are signed by the audit committee. The proposed conforming amendment to ISA 210 requires that the auditor agree with management on the assumptions about management activities and beliefs essential

to the performance of an audit. Therefore, even though the terms of engagement are signed by the audit committee, the auditor still needs to address the issue of the assumptions with relevant persons prior to agreeing to the terms of the engagement.

With respect to the issue of inconsistencies between the assumptions in the terms of engagement and representation letter, and their communication to those charged with governance, the task force is of the view that this is addressed in ISA 260 (Revised and Redrafted), “Communication with Those Charged with Governance,” paragraph 16(c)(iii). This paragraph requires the auditor to communicate, among other audit findings, with those charged with governance representations that the auditor requests from management.

#### OBJECTIVE OF ISA 580

Two CAG Representatives raised the issue of the objective of the ISA. Their concerns included the following:

- The objective should be formulated in terms of outcomes.
- The IAASB should communicate the objective of representation letters to preparers, auditors and users.

The task force discussed this issue in light of the latest developments of the Clarity project and agreed that, based on the results of this discussion; the objective should be for the auditor to determine whether the assumptions underlying an audit of financial statements are appropriate in the context of a particular audit engagement. The proposed objective is as follows:

*The objective of the auditor is to obtain sufficient appropriate audit evidence in the form of written representations in order to corroborate other evidence obtained regarding:*

*(a) Assumptions about management's activities and beliefs that are essential to the performance of an audit of financial statements; and*

*(b) Specific assertions embodied in the financial statements.*

<h4><b>Action Requested</b></h4> <p>Does the IAASB agree with the task force’s conclusions on the link between the terms of engagement and the representation letter?</p>
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#### MATERIALITY

The IAASB suggested that use of the term “materiality” in relation to written representations should be reconsidered and the requirement should be relegated to the application material because it relates primarily to specific written representations. Further, it should be made clear that such “materiality” would be different for different items for which a specific written representation is requested. Also, the term used should not imply that it is “tolerable error.”

The task force is of the view that, in the context of the ISA, the auditor may reach an understanding with relevant persons on “materiality” for the purposes of written representations. The materiality for purposes of written representations is lower than materiality for planning and performing the audit. Written representations should be limited to matters that are, either individually or collectively, “material” in the context of written representations. It is likely that such “materiality” would be

different for different written representations. In addition, the auditor recognizes that for certain matters, such as fraud, the auditor's considerations do not involve materiality. To document the understanding reached by the auditor and relevant persons on materiality, the auditor may wish to discuss the "materiality" for purposes of written representations in the written representations letter.

The task force recognized, however, that use of the term "material" in the context of written representations may lead to confusion as to the meaning of such "materiality." Therefore, the task force has proposed to use the term "threshold amount" instead. The task force agreed that the discussion of threshold amount should be included in the application material and the material was repositioned (see Agenda item 7-A, paragraph A12).

<p><b>Action Requested</b></p> <p>Does the IAASB agree with the task force's conclusions on "materiality" for purposes of written representations?</p>
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**Action Requested**

The IAASB is asked to review the proposed draft ISA and approve it for public exposure.

**Material Presented**

Agenda Item 7-A (Pages 2613 to 2626)	Proposed ISA 580, "Written Representations" (Revised and Redrafted) - CLEAN
Agenda Item 7-B (Pages 2627 to 2646)	Proposed ISA 580, "Written Representations" (Revised and Redrafted) – MARK-UP

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