



**International Federation of Accountants**

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

## Agenda Item

# 6

**Committee:** IAASB

**Meeting Location:** Washington D.C.

**Meeting Date:** December 10-14, 2007

### **Proposed ISA 580 (Revised and Redrafted), “Written Representations”**

#### **Objectives of Agenda Item**

1. To approve:
  - (a) Proposed ISA 580 (Revised and Redrafted) as a final standard, subject to finalizing proposed ISAs 200 (Revised and Redrafted),<sup>1</sup> 210 (Redrafted)<sup>2</sup> and 700 (Redrafted).<sup>3</sup> The proposed way forward is described in paragraphs 37-40 of this paper; and
  - (b) Proposed ISA 210 (Redrafted) to be issued as an exposure draft. In September, the IAASB approved proposed ISA 210 (Redrafted), subject to the conforming amendments as a result of proposed ISA 580 (Revised and Redrafted).

#### **Task Force Members**

2. The Task Force members are as follows:

John Fogarty (Chair)

Josef Ferlings

Sylvia Smith

David Swanney

#### **Task Force Activities**

3. Following the discussion of responses to the exposure draft at the September IAASB meeting, the Task Force held two telephone conferences to discuss the comments of the IAASB, IAASB Consultative Advisory Group (CAG) and IFAC Small and Medium Practices Committee.

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<sup>1</sup> Proposed ISA 200 (Revised and Redrafted), “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

<sup>2</sup> Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements.”

<sup>3</sup> Proposed ISA 700 (Redrafted), “The Independent Auditor’s Report on General Purpose Financial Statements.”

## **Matters for IAASB Consideration**

4. For purposes of this paper, references to “management” should be read as “management and, where appropriate, those charged with governance.”

### **OBJECTIVES**

5. Some IAASB members and IAASB CAG Representatives expressed concern about the term “corroborate,” and the limitation of written representations about specific assertions in the financial statements to those assertions that involve judgment, intent or completeness.
6. The Task Force proposes that the Objectives in proposed ISA 580 (Revised and Redrafted) read as follows:  
“6. The objectives of the auditor are:
  - (a) To obtain written evidence from management that it believes that it has fulfilled those fundamental responsibilities included in the premise on which an audit is conducted;
  - (b) Where necessary, to support other audit evidence by means of written representations about specific assertions in the financial statements; and
  - (c) To respond appropriately to written representations obtained or if they are not provided.”

### **WRITTEN REPRESENTATION ABOUT MANAGEMENT’S RESPONSIBILITY FOR THE PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS**

#### *Engagement Letter vs. Representation Letter*

7. Some IAASB members and IAASB CAG Representatives noted that management’s responsibility for the preparation and presentation of the financial statements is often established by law or regulation. Furthermore, as required by proposed ISA 210 (Redrafted), the terms of the audit engagement states that management acknowledges and understands its responsibility for the preparation and presentation of the financial statements. As a result, management may consider it unnecessary to provide a written representation that repeats that fact.
8. In line with the preliminary proposal, which was generally accepted at the September IAASB meeting, the Task Force proposes that the terms of the audit engagement contain the agreement with management about its responsibility, while the representation letter confirms that management has fulfilled that responsibility. That is:
  - (a) As required by proposed ISA 210 (Redrafted), the terms of the audit engagement should state that management acknowledges and understands its responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement,

whether due to fraud or error. (See paragraph 4(b)(i) of proposed ISA 210 (Redrafted).)

- (b) Management should be requested to provide a written representation that it has fulfilled its responsibility for the preparation and presentation of the financial statements as set out in the terms of the audit engagement and, in particular, whether the financial statements are prepared and presented in accordance with the applicable financial reporting framework. (See paragraph 10 of proposed ISA 580 (Revised and Redrafted).)

#### *Management's Responsibilities Prescribed by Law or Regulation*

- 9. If law or regulation prescribes management's responsibilities, and the auditor has determined that those responsibilities are *equivalent in effect* to some or all of those described in paragraph 4(b) of proposed ISA 210 (Redrafted), the terms of the audit engagement may reflect the wording of the law or regulation instead of the corresponding wording in paragraph 4(b). (See paragraph 5 of proposed ISA 210 (Redrafted).) Paragraph A12 of proposed ISA 210 (Redrafted) explains that, in some jurisdictions, the accounting profession or a national standard setter, on behalf of auditors, may consider whether the responsibilities established by law or regulation are equivalent in effect to those described in paragraph 4(b) of the ISA.

#### *New Matter for Consideration by the IAASB*

- 10. Paragraph 8 of proposed ISA 210 (Redrafted) requires the auditor to agree the terms of the audit engagement with management or those charged with governance. Unless sufficiently specified by law or regulation, the agreed terms of the audit engagement have to be recorded in an audit engagement letter or other suitable form of written agreement.
- 11. Management's responsibilities may thus not be stated in an audit engagement letter or other written agreement, i.e., when the terms of the audit engagement are sufficiently specified by law or regulation. If they are not stated in an audit engagement letter or other written agreement, it will cause a problem for the proposal in paragraph 8(b) of this paper that the auditor request management to provide a written representation that it has fulfilled its responsibility for the preparation and presentation of the financial statements *as set out in the terms of the audit engagement*.
- 12. This may be addressed by:
  - (a) Inserting a new paragraph after paragraph 12 of proposed ISA 580 (Revised and Redrafted) that reads as follows: "If, exceptionally, the terms of the audit engagement are not recorded in an engagement letter or other written agreement,<sup>4</sup> the auditor shall request that the written representations about management's

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<sup>4</sup> Proposed ISA 210 (Redrafted), paragraph 8.

responsibilities include management's acknowledgement and understanding of its responsibilities.<sup>5</sup>"

- (b) Amending paragraph A9 of proposed ISA 580 (Revised and Redrafted) as follows:  
"The written representations required by paragraphs 10 and 11 draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. If, exceptionally, the terms of the audit engagement are not recorded in an engagement letter or other written agreement because they are sufficiently specified by law or regulation,<sup>6</sup> the auditor is required to request management to include such acknowledgement and understanding in the written representations. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is common in certain jurisdictions, but in any event may be particularly appropriate when ..."  
(It may be necessary to reposition this paragraph.)

**Action Requested:**

**The IAASB is asked for their views with regard to this matter.**

*Term "Internal Control"*

13. Some IAASB members expressed concern about the term "internal control." Examples provided during the meeting indicated that the term may have different meanings in different jurisdictions. In the United Kingdom, for example, law or regulation refers to accounting books and records, while in the United States reference is made to internal control.
14. The Task Force debated at length whether and, if so, how to deal with internal control in the context of the premise, the terms of the audit engagement, the written representations, and the auditor's report. The Task Force noted that extant ISA 210 states that "the form and content of audit engagement letters may vary for each client, but they would generally include reference to ... management's responsibility for establishing and maintaining effective internal control."<sup>7</sup> Extant ISA 240 requires the auditor to obtain a written representation from management that it acknowledges its responsibility for the design and implementation of internal control to prevent and detect fraud.<sup>8</sup> Statements by management about internal control are thus not new to ISAs. In addition (and as discussed in paragraph 9 of this paper), the Task Force proposes flexibility in how management's responsibilities (which include a reference to internal control) are being described in the terms of the audit engagement, the written representations, and the auditor's report.

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<sup>5</sup> Proposed ISA 210 (Redrafted), paragraph 4(b).

<sup>6</sup> Proposed ISA 210 (Redrafted), paragraph 8.

<sup>7</sup> ISA 210, "Terms of Audit Engagements," paragraph 6.

<sup>8</sup> ISA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements," paragraph 90(a).

15. Taking account of the above, the Task Force proposes that the guidance on internal control in proposed ISA 580 (Revised and Redrafted) be moved to proposed ISA 210 (Redrafted).
- (a) Paragraph A15 contains the definition for internal control as per ISA 315 (Redrafted).<sup>9</sup>
  - (b) Paragraph A16 explains that internal control is an important aspect of management's responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. Accordingly, the auditor obtains management's agreement that it acknowledges and understands that this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.
  - (c) Paragraph A17 explains that, in some jurisdictions, law or regulation may refer to the responsibility of management for the adequacy of accounting books and records, or accounting systems. As books, records and systems are an integral part of internal control as defined, no specific reference is made to them in paragraph 4(b)(i) of proposed ISA 210 (Redrafted) for the description of management's responsibility. The text is from extant ISA 700.<sup>10</sup>
16. Some IAASB members were also concerned that owner-managers of small entities may be reluctant to agree that they acknowledge and understand their responsibility for the preparation and presentation of the financial statements, including internal control. The Task Force proposes additional considerations specific to smaller entities – see paragraphs A19-A20 of proposed ISA 210 (Redrafted). This text, appropriately amended, is from International Auditing Practice Statement (IAPS) 1005.<sup>11</sup>

#### WRITTEN REPRESENTATION ABOUT INFORMATION PROVIDED TO THE AUDITOR

##### *Providing the Auditor with All the Information the Auditor Requires in Connection with the Audit*

17. Some IAASB members and IAASB CAG Representatives questioned whether it was correct to refer to the information the auditor *requires* in connection with the audit. An IAASB CAG Representative suggested “requests.” An IAASB member suggested “reasonably required.”
18. The Task Force is of the view that, if the responsibility is limited to information that the auditor requests, management could withhold information on the basis that the auditor did not request it. However, the Task Force accepts that management may not

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<sup>9</sup> ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.”

<sup>10</sup> ISA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements,” footnote 10.

<sup>11</sup> IAPS 1005, “The Special Considerations in the Audit of Small Entities.”

know what information the auditor requires in connection with the audit. The Task Force therefore proposes that the proposed ISAs describe the information that management is responsible for providing to the auditor. For example, the description of the premise in paragraph 8(b) of proposed ISA 200 (Revised and Redrafted) states that “management ... has responsibility ... to provide the auditor with:

- (i) All information that is relevant to the preparation and presentation of the financial statements, such as records, documentation, and other matters that support the financial statements;
- (ii) Any additional information that the auditor may request from management; and
- (iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.”

*Written Representation about Deficiencies in Internal Control*

- 19. Proposed ISA 580 (Revised and Redrafted) presented at the September IAASB meeting contained a requirement for a written representation about deficiencies in internal control. The Task Force inserted this requirement when the requirement for a written representation about the adequacy of internal control for purposes of the preparation and presentation of the financial statements in the exposure draft was deleted as a result of comments on the exposure draft.
- 20. Few IAASB members were of the view that that the written representation about deficiencies in internal control created the same difficulty as the previously required written representation about the adequacy of internal control. In addition, the IFAC Small and Medium Practices Committee and an IAASB member were concerned about the application of the requirement in the audit of a smaller entity; another IAASB member was concerned that failure to obtain the written representation may result in a disclaimer of opinion; and other IAASB members suggested that the requirement be qualified in one way or another.
- 21. The Task Force considered the arguments put forward by the IAASB members and IFAC Small and Medium Practices Committee, and proposes that the requirement for a written representation about deficiencies in internal control be deleted. This does not, however, preclude the auditor from requesting such written representation should the auditor consider it necessary.

**Action Requested:**

**The IAASB is asked to confirm whether they agree with this proposal.**

**WRITTEN REPRESENTATIONS TO BE PROVIDED AFTER HAVING MADE APPROPRIATE INQUIRIES**

- 22. Some IAASB members requested that the Task Force re-instate the phrase “having made appropriate enquiries.” Based on comments on the exposure draft, the Task Force concluded that, due to its responsibility for the preparation and presentation of the financial statements, management would be expected to have sufficient knowledge of

the process followed by the entity in preparing and presenting the financial statements and assertions therein on which to base the written representations. The Task Force therefore recommended in September that this be clarified in the application material and that the phrase “having made appropriate inquiries for them to be able to provide such representations” be deleted.

23. The Task Force considered the IAASB members’ request that the phrase be re-instated. Taking account of the comments on the exposure draft and the IAASB members’ comments, the Task Force proposes that the auditor be required to request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned (see paragraph 9 of proposed ISA 580 (Revised and Redrafted)). Paragraphs A5 and A6 explain that, due to its responsibility for the preparation and presentation of the financial statements, and its responsibilities for the conduct of the entity’s business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations. In some cases, however, management may consider it necessary to make inquiries to inform it about relevant matters to be able to provide such written representations. It is not expected that such inquiries would usually require a formal internal process beyond those already established by the entity.
24. In addition, paragraph A7 of proposed ISA 580 (Revised and Redrafted) explains that, in some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations. In such circumstances, and to reinforce the need for management to make informed representations, the auditor may request that management include in the written representations confirmation that it has made such enquiries as it considered appropriate to place it in the position to be able to make the requested written representations.

#### WRITTEN REPRESENTATIONS TO BE ADDRESSED TO THE AUDITOR

25. Some IAASB members questioned whether written representations have to be addressed to the auditor. They referred to the fact that management’s confirmation of the fulfilment of its responsibility for the preparation and presentation of the financial statements, and the fact that the financial statements are prepared and presented in accordance with the applicable financial reporting framework, may be included in a signed statement that accompanies the financial statements. As a result, management may not consider it necessary to make such statement again in the representation letter.
26. The Task Force considered the arguments put forward by the IAASB members, and proposes that the requirement read as follows: “The written representations shall be in the form of a representation letter addressed to the auditor. If, exceptionally, the auditor determines that other formal written statements by management provide the necessary representations, the relevant matters covered by such statements need not be included

in the representation letter.” (See paragraph 15 of proposed ISA 580 (Revised and Redrafted).)

27. Paragraph A20 of proposed ISA 580 (Revised and Redrafted) explains that, in some jurisdictions, management may be required by law or regulation to make a written public declaration in relation to the financial statements. Although such declaration is a representation to the users of the financial statements, or to relevant authorities, the auditor may determine that it is an appropriate form of written representation in respect of certain of management’s responsibilities. Factors that may affect the auditor’s determination include:
- Whether the declaration includes confirmation of the fulfillment of responsibilities that are equivalent to some or all of those set out in the terms of the audit engagement.
  - Whether the declaration has been given or approved by those from whom the auditor requests the relevant written representations.
  - Whether a copy of the declaration is provided to the auditor as near as practicable to, but not after, the date of the auditor’s report on the financial statements.
28. In addition, paragraph A21 of proposed ISA 580 (Revised and Redrafted) explains that a formal statement of compliance with law or regulation, or of approval of the financial statements, would not contain sufficient information for the auditor to be satisfied that all necessary representations have been consciously made. The expression of management’s responsibilities in law or regulation is also not a substitute for the requested written representations.

#### DISCLAIMER OF OPINION

##### *Written Representations about Management’s Responsibilities*

29. Some IAASB members and IAASB CAG Representatives were of the view that more flexibility should be allowed with regard to the written representation about management’s fulfilment of its responsibility for the preparation and presentation of the financial statements. An IAASB member, for example, was of the view that the auditor may have obtained sufficient appropriate other audit evidence on which to base the opinion and should therefore be allowed to apply professional judgment in this regard.
30. The Task Force believes that the auditor should be required to disclaim an opinion in accordance with proposed ISA 705 (Revised and Redrafted)<sup>12</sup> if the auditor concludes that the written representations required by paragraphs 10 and 11 of proposed ISA 580 (Revised and Redrafted) are not reliable or if management does not provide them. (See paragraph 20 of proposed ISA 580 (Revised and Redrafted).) Paragraph 10 requires the auditor to request management to provide a written representation that it has fulfilled its responsibility for the preparation and presentation of the financial statements as set

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<sup>12</sup> ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”



out in the terms of the audit engagement and, in particular, whether the financial statements are prepared and presented in accordance with the applicable financial reporting framework. Paragraph 11 requires the auditor to request management to confirm that it has provided the auditor with all relevant information as agreed in the terms of the audit engagement, and that all transactions have been recorded and are reflected in the financial statements.

31. Paragraph A28 of proposed ISA 580 (Revised and Redrafted) explains that the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. Therefore, if the auditor concludes that the written representations about these matters are unreliable, or if management does not provide them, the auditor is unable to obtain sufficient appropriate audit evidence. The possible effects on the financial statements of such inability are not confined to specific elements, accounts or items of the financial statements and are hence pervasive. The auditor is required to disclaim an opinion on the financial statements in such circumstances.

#### *Other Written Representations*

32. Paragraph 13 of proposed ISA 580 (Revised and Redrafted) notes that other ISAs contain requirements for written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor is required to request such other written representations.
33. Some IAASB members were concerned that the auditor's conclusion that other written representations are unreliable, or refusal by management to provide them, may give rise to an automatic disclaimer of opinion. They referred to paragraph A28 of proposed ISA 580 (Revised and Redrafted) presented at the September IAASB meeting. The Task Force agrees that that paragraph could be interpreted incorrectly and proposes that it be deleted.
34. The Task Force is of the view that the requirements in paragraph 16-18 of proposed ISA 580 (Revised and Redrafted), which deals with doubt as to the reliability of written representations, and paragraph 19, which deals with requested written representations not provided by management, apply to all requested written representations (that is, those about management's responsibilities, those required by other ISAs, and those about specific assertions in the financial statements). Paragraph 20, which requires a disclaimer of opinion in specified circumstances, applies to written representations required by paragraphs 10 and 11 of proposed ISA 580 (Revised and Redrafted) only.
35. Accordingly, if the auditor concludes that other written representations are not reliable, the auditor is required to take appropriate action; this includes determining the possible effect on the opinion in the auditor's report in accordance with proposed ISA 705 (Revised and Redrafted) (see paragraph 18 of proposed ISA 580 (Revised and Redrafted)).

36. If management do not provide one or more of the requested other written representations, the auditor is required to follow the requirements in (a)-(c) of paragraph 19 of proposed ISA 580 (Revised and Redrafted), which includes taking appropriate action, including determining the possible effect on the opinion in the auditor's report in accordance with proposed ISA 705 (Revised and Redrafted).

**Should Proposed ISA 580 (Revised and Redrafted) be Re-exposed?**

37. The Task Force is of the view that the changes to proposed ISA 580 (Revised and Redrafted) respond to the comments received on the exposure draft, and that there are no substantial changes that warrant re-exposure of the proposed ISA as a whole.
38. It is envisaged that the exposure draft of proposed ISA 210 (Redrafted) will be approved at the December IAASB meeting. The proposed conforming amendments as a result of proposed ISA 580 (Revised and Redrafted) form part of that exposure draft.
39. The Task Force proposes that the proposed conforming amendments to ISA 700 (Redrafted) as a result of proposed ISA 580 (Revised and Redrafted), which affect the description of management's responsibility for the financial statements in the auditor's report, be exposed for public comment.
40. Due to the interrelationship between ISAs 200 (Revised and Redrafted), 210 (Redrafted), 580 (Revised and Redrafted) and 700 (Redrafted), the Task Force proposes that proposed ISA 580 (Revised and Redrafted) is approved as a final standard, subject to any limited changes that prove to be necessary as a result of exposing and finalizing proposed ISA 210 (Redrafted) and finalizing proposed ISAs 200 (Revised and Redrafted) and 700 (Redrafted).

**Material Presented**

Agenda Item 6-A (Pages 3297 – 3300)	Proposed Conforming Amendments to Proposed ISA 200 (Revised and Redrafted)
Agenda Item 6-B (Pages 3301 – 3324)	Proposed Conforming Amendments to Proposed ISA 210 (Redrafted)
Agenda Item 6-C (Pages 3325 – 3346)	Proposed ISA 580 (Revised and Redrafted) – MARK-UP FROM SEPTEMBER IAASB MEETING DRAFT
Agenda Item 6-D (Pages 3347 – 3350)	Proposed Conforming Amendments to Proposed ISA 700 (Redrafted)
Agenda Item 6-E (Pages 3351 – 3366)	Proposed ISA 580 (Revised and Redrafted) – CLEAN

**Agenda Item 6-E will be used for purposes of discussing proposed ISA 580 (Revised and Redrafted).**

**Action Requested**

41. The IAASB is asked to approve:
  - (a) Proposed ISA 580 (Revised and Redrafted) as a final standard, subject to finalizing proposed ISAs 200 (Revised and Redrafted), 210 (Redrafted) and 700 (Redrafted).
  - (b) Proposed ISA 210 (Redrafted) to be issued as an exposure draft.

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