

EXPOSURE DRAFT

ED 19/05
(October 2005)

Proposed Auditing Standard: Management Representations (Re-issuance of AUS 520)

Prepared and Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by 15 December 2005. Comments should be addressed to:

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A copy of all non-confidential submissions will be placed on public record on the AUASB website: www.auasb.gov.au.

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PREFACE

Reasons for Issuing ED 19/05

The Auditing and Assurance Standards Board (AUASB) is proposing to re-issue Auditing Standard (AUS 520) *Management Representations* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards will be legislative instruments under the *Legislative Instruments Act 2003*.

Main Proposals

This proposed Auditing Standard:

- (a) establishes mandatory requirements and provides explanatory guidance on the audit evidence aspects of management representations;
- (b) provides explanatory guidance on the documentation of representations by management; and
- (c) identifies the action to be taken if management refuses to provide appropriate representations.

Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from existing AUS 520 (July 2002)

The main differences between this proposed Auditing Standard and the Auditing Standard issued by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation that it supersedes, AUS 520 *Management Representations* (July 2002), is that in this proposed Auditing Standard:

1. the word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility was previously described by the word 'should';
2. the explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas previously some obligations were implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance; and
3. the terminology and overall concepts have been aligned to the Audit Risk Standards and the Fraud Standard. The issue and re-issue of the Audit Risk Standards in February 2004 and the Fraud Standard in June 2004, comprising:
 - AUS 402 "Understanding the Entity and Its Environment and Assessing the Risks of Misstatement";
 - AUS 406 "The Auditor's Procedures in Response to Assessed Risks";
 - AUS 502 "Audit Evidence"; and
 - AUS 210 "The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report"

gave rise to necessary conforming amendments to certain existing AUSs, including AUS 520.

A Table of Proposed Changes, excluding conforming amendments mentioned at point 3 above, is provided as an attachment to the Exposure Draft.

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Request for Comments

Comments are invited on this Exposure Draft of the proposed re-issuance of Auditing Standard (AUS 520) *Management Representations* by 15 December 2005. The AUASB would prefer that respondents express a clear overall opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. The AUASB regards both critical and supportive comments as essential to a balanced review of the proposed Auditing Standard.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard << >> *Management Representations* as set out in paragraphs 1 to 24 and Appendix 1, pursuant to section 227B of the *Australian Securities and Investment Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

AUDITING STANDARD

Management Representations

Application

- 1 **This Auditing Standard applies to:**
 - (a) **an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and**
 - (b) **an audit of a financial report for any other purpose.**
- 2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

- 3 **This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.**

Introduction

- 4 The purpose of this Auditing Standard is to establish mandatory requirements and provide explanatory guidance on the use of management representations as audit evidence, the procedures to be applied in evaluating and documenting management representations and the action to be taken if management refuses to provide appropriate representations.
- 5 **The auditor shall endeavour to obtain appropriate representations from management.**
- 6 In certain audit engagements some of the representations sought by the auditor from management are required to be given in other appropriate forms, for example the directors' report and the directors' declaration required under the *Corporations Act 2001*, or in meeting the requirements of other governing regulations of an entity. Where the directors or management make representations required by statute or regulation concerning the financial report, the auditor need not seek a further representation on those matters.

Acknowledgment by Management of its Responsibility for the Financial Report

- 7 **The auditor shall obtain sufficient appropriate audit evidence that management acknowledges its responsibility for the fair presentation of the financial report in accordance with the applicable financial reporting framework, and has approved the financial report.**
- 8 The auditor can obtain audit evidence of management's acknowledgement of such responsibility and approval from relevant minutes of meetings of those charged with governance, or by obtaining a written representation from management or a signed copy of the financial report.

Representations by Management as Audit Evidence

- 9 **The auditor shall endeavour to obtain written representations from management on matters material to the financial report, when other sufficient appropriate audit evidence cannot reasonably be expected to exist.**
- 10 The possibility of misunderstandings between the auditor and management is reduced when oral representations are confirmed by management in writing. Matters that might be included in a letter from management or in a confirmatory letter to management are contained in the example of a management representation letter in the Appendix to this Auditing Standard.
- 11 Written representations requested from management may be limited to matters that are considered either individually or collectively material to the financial report. Regarding certain items it may be necessary to inform management of the auditor's understanding of materiality.
- 12 **The auditor shall endeavour to obtain written representations from management that:**
- (a) it acknowledges its responsibility for the design and implementation of internal control to prevent and detect error; and**

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- (b) **it believes the effects of those uncorrected financial report misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial report taken as a whole. A summary of such items shall be included in or attached to the written representations.**
- 13 During the course of an audit, management makes many representations to the auditor, either unsolicited or in response to specific inquiries. When such representations relate to matters which are material to the financial report, the auditor ordinarily needs to:

 - (a) seek corroborative audit evidence from sources inside or outside the entity;
 - (b) evaluate whether the representations made by management appear reasonable and consistent with other audit evidence obtained, including other representations; and
 - (c) consider whether the individuals making the representations can be expected to be well informed on the particular matters.
- 14 Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. For example, a representation by management as to the cost of an asset is not a substitute for the audit evidence of such cost that an auditor would ordinarily expect to obtain. If the auditor is unable to obtain sufficient appropriate audit evidence regarding a matter which has, or may have, a material effect on the financial report, and such audit evidence is expected to be available, pursuant to AUS 702, “The Audit Report on a General Purpose Financial Report”, this will constitute a limitation on the scope of the audit, even if a representation from management has been received on the matter.
- 15 In certain instances, audit evidence other than that obtained by performing inquiry may not be reasonably expected to be available; therefore the auditor ordinarily obtains a written representation by management. For example, the auditor may not be able to obtain other audit evidence to corroborate management’s intention to hold a specific investment for long-term appreciation.
- 16 **If a representation by management is contradicted by other audit evidence, the auditor shall investigate the circumstances and, when necessary, reconsider the reliability of other representations made by management.**

Documentation of Representations by Management

- 17 The auditor would ordinarily include in audit working papers evidence of management's representations in the form of a summary of oral discussions with management or written representations from management.
- 18 A written representation is ordinarily more reliable audit evidence than an oral representation and can take the form of:
- (a) a representation letter from management;
 - (b) a letter from the auditor outlining the auditor's understanding of management's representations, duly acknowledged and confirmed by management; or
 - (c) relevant minutes of meetings of the board of directors or similar body or a signed copy of the financial report.

Basic Elements of a Management Representation Letter

- 19 Pursuant to paragraph 9 of this Auditing Standard, when requesting a management representation letter, the auditor would request that it be addressed to the auditor, contain specified information and be appropriately dated and signed.
- 20 A management representation letter would ordinarily be dated the same date as the auditor's report. However, in certain circumstances, a separate representation letter regarding specific transactions or other events may also be obtained during the course of the audit.
- 21 A management representation letter would ordinarily be signed by the members of management who have primary responsibility for the entity and its financial aspects, (ordinarily the senior executive officer and the senior financial officer), based on the best of their knowledge and belief. In certain circumstances, the auditor may wish to obtain representation letters from other members of management. For example, the auditor may wish to obtain a written representation about the completeness of all minutes of the meetings of shareholders, the board of directors and important committees from the individual responsible for keeping such minutes.

Action if Management Refuses to Provide Representations

- 22 **If management refuses to provide a representation that the auditor considers necessary, this constitutes a scope limitation and the auditor shall express a qualified opinion or a disclaimer of opinion.**
- 23 In such circumstances the auditor would ordinarily:
- (a) evaluate any reliance placed on other representations made by management during the course of the audit;
 - (b) draw to the attention of the directors or management any relevant statutory and/or regulatory provision which gives the auditor access to records and information. For example, under section 310 of the *Corporations Act 2001*, the auditor has a right of access at all reasonable times to the books of a company, registered scheme or disclosing entity, and may require from any officer to give the auditor information and explanations or other assistance for the purposes of the audit or review; and
 - (c) consider if the other implications of the refusal may have any additional effect on the auditor's report. For example, section 307(b) of the *Corporations Act 2001* requires an auditor to form an opinion as to whether all information, explanations and assistance necessary for the conduct of the audit have been given, and in accordance with section 308(3)(b) to state in the auditor's report particulars of any deficiency, failure or shortcoming in respect of these matters.

Conformity with International Standards on Auditing

- 24 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 580, "Management Representations", issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The differences between this Auditing Standard and ISA 580 are:

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- there is no corresponding paragraph 6 or 23(b) in ISA 580; and
- there is no corresponding example in paragraph 23(c) in ISA 580.

Compliance with this Auditing Standard enables compliance with ISA 580.

APPENDIX 1

EXAMPLE OF A MANAGEMENT REPRESENTATION LETTER

This Appendix provides additional guidance and / or illustrative examples to assist auditors with the application of the mandatory requirements of the Auditing Standard, but does not form part of or add to those mandatory requirements.

The following letter is not intended to be a standard letter. Representations by management will vary from one entity to another and from one period to the next.

Although seeking representations from management on a variety of matters, a management representation letter may serve to focus management's attention on those matters, and thus cause management to specifically address those matters in more detail than would otherwise be the case. The limitations of management representations as audit evidence are set out in this Auditing Standard.

Example Letter

[Entity Letterhead]

[Addressee – Auditor]

[Date]

[This representation letter is provided in connection with your audit of the financial report of [name of entity] for the [period] ended [date], for the purpose of you expressing an opinion as to whether the financial report is, in all material respects, presented fairly in accordance with Accounting Standards [and, when appropriate, relevant statutory and other requirements].¹

We acknowledge our responsibility for ensuring that the financial report is in accordance with Accounting Standards [and, when appropriate, relevant statutory and other requirements],¹ and confirm that the financial report is free of material misstatements, including omissions.]

OR

¹ Wording to be amended to reflect the reporting requirements of specific regulatory requirements governing an engagement, for example the *Corporations Act 2001*.

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[This representation letter is provided in connection with your audit of the financial report of [name of entity] for the [period] ended [date], for the purpose of you expressing an opinion as to whether the financial report is, in all material respects, in accordance with:

- (a) the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the [company/entity]'s financial position as at [date] and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory professional reporting requirements in Australia.

We acknowledge our responsibility for ensuring that the financial report is in accordance with:

- (a) the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the [company/entity]'s financial position as at [date] and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory professional reporting requirements in Australia,

and confirm that the financial report is free of material misstatements, including omissions.]

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

[Include representations relevant to the entity. Such representations may include the following examples.]

- 1. We have made available to you:
 - (a) all financial records and related data, other information, explanations and assistance necessary for the conduct of the audit; and
 - (b) minutes of all meetings of [shareholders, directors, committees of directors].

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2. There:
 - (a) has been no fraud, error or non-compliance with laws and regulations involving management or employees who have a significant role in the internal control structure;
 - (b) has been no fraud, error or non-compliance with laws and regulations that could have a material effect on the financial report;
 - (c) have been no communications from regulatory agencies concerning non-compliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial report.
3. We have established and maintained an adequate internal control structure to facilitate the preparation of a reliable financial report, and adequate financial records have been maintained. There are no material transactions that have not been properly recorded in the accounting records underlying the financial report.
4. We have no plans or intentions that may materially affect the carrying values, or classification, of assets and liabilities.
5. We have considered the requirements of [AASB 136, “Impairment of Assets”,] when assessing the impairment of assets and in ensuring that no assets are stated in excess of their recoverable amount.
6. The following have been properly recorded and/or disclosed in the financial report:
 - (a) related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements and guarantees (written or oral);
 - (b) share options, warrants, conversions or other requirements;
 - (c) arrangements involving restrictions on cash balances, compensating balances and line-of-credit or similar arrangements;
 - (d) agreements to repurchase assets previously sold;
 - (e) material liabilities or contingent liabilities or assets including those arising under derivative financial instruments;

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- (f) unasserted claims or assessments that our lawyer has advised us are probable of assertion; and
 - (g) losses arising from the fulfilment of, or an inability to fulfil, any sale commitments or as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.
7. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial report or as a basis for recording an expense.
 8. The entity has satisfactory title to all assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral. Allowances for depreciation have been adjusted for all important items of property, plant and equipment that have been abandoned or are otherwise unusable.
 9. The entity has complied with all aspects of contractual agreements that would have a material effect on the financial report in the event of non-compliance.
 10. There were no material commitments for construction or acquisition of property, plant and equipment or to acquire other non-current assets, such as investments or intangibles, other than those disclosed in the financial report.
 11. We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of net realisable value.
 12. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial report.

We understand that your examination was made in accordance with Australian Auditing Standards and was, therefore, designed primarily for the purpose of expressing an opinion on the financial report of the entity taken as a whole, and that your tests of the financial records and other auditing procedures were limited to those which you considered necessary for that purpose.

Yours faithfully

[Name of signing officer and title]

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Notes:

[The above example representation letter may need to be amended in certain circumstances. The following illustrate some of those situations.]

(a) Exceptions

Where matters are disclosed in the financial report, the associated representation needs to be amended, for example:

- If a subsequent event has been disclosed, Item 12 could be modified to read:

“Except as discussed in Note X to the financial report, no events have occurred”.

- If the entity has plans that impact the carrying values of assets and liabilities, Item 11 could be modified to read:

“The entity has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plan to dispose of segment X, as disclosed in note Y in the in the financial report, which is discussed in the minutes of the meeting of the governing body held on [date]”.

(b) Other Required Information

Certain entities may be required to include other information in the financial report, for example, performance indicators for government entities. In addition to identifying this information and the relevant reporting framework in paragraphs 1 and 2 of the example letter, an additional paragraph similar to the following may be appropriate:

“The disclosures of key performance indicators have been prepared and presented in conformity with [relevant statutory requirements] and we consider the indicators reported to be relevant to the stated objectives of the [entity]”.

(c) Management’s Opinions and Representation in the Notes to the Financial Statements

Where the notes to the financial statements include opinions and representations by management, such matters could be addressed in the letter. For example, notes relating to the anticipated outcome of

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litigation, the intent and ability to hold long-term securities to maturity and plans necessary to support the going concern basis.

(d) Environmental Matters

In situations where there are environmental matters that may, but probably will not, require an outflow of resources, this could be reflected in an addition to Item 7, for example:

“However, the [entity] has received a notice from the Environmental Protection Agency that it may be required to share in the cost of cleanup of the [name] waste disposal site. This matter has been disclosed in Note A in the financial report and we believe that the disclosure and estimated contingent loss is reasonable based on available information”.

(e) Compliance

If as part of the audit, the auditor is also required to report on the entity’s compliance with laws and regulations, a representation may be appropriate acknowledging that management is responsible for the entity’s compliance with applicable laws and regulations and that the requirements have been met. For example, for audits under the *Corporations Act 2001*, the following paragraph could be added:

“The financial records of the [company, registered scheme or disclosing entity] have been kept so as to be sufficient to enable a financial report to be prepared and audited, and other records and registers required by the *Corporations Act 2001* have been properly kept and are up-to-date”.

(f) Other Matters

Additional representations that may be appropriate in specific situations may include the following:

- Justification for a change in accounting policy.
- The work of a specialist has been used.
- Arrangements for controlling the dissemination of the financial report and auditor’s report on the Internet.

Table of Proposed Changes from AUS 520 <i>Management Representations</i>

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
1, 2	Requirement / Guidance	New Application paragraph.
3	Requirement	Re-position Operative Date paragraph.
5, 7, 9, 12, 16, 22	Requirement	Replace “should” with “shall”.
5, 9, 12	Requirement	Insert “endeavour to”.
7, 8, 14, 15, 18	Requirement / Guidance	Changes arising from the 2004 audit risk conforming amendments.
7	Requirement	The words ‘sufficient appropriate’ have been retained from the AUS but this departs from the ISA.
9	Requirement	The word “specific” has been deleted from the Auditing Standard as it is not in ISA 580.
10, 18, 21, 22, 23	Requirement / Guidance	Change to conform to ISA 580.
12	Requirement	Add paragraph to conform to ISA 580.
13, 15, 23	Guidance	Insert “ordinarily” to clarify implied obligations.
14, 19	Guidance	Insert “pursuant to [AUS <<>>] / [paragraph xx of this Auditing Standard] ..” to clarify implied obligations.
20	Guidance	Delete “or at a date after the date of the audit report, for example on the date of a public offering.”

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
Appendix 1	Appendix	The appendix used is from the existing AUS rather than the ISA. Alternative wording to the reporting framework has been proposed. Reference to AASB 1010 has been updated to AASB 136. Delete Year 2000 paragraph. Remove references to UIG Consensus Views.