



MANAGEMENT REPRESENTATION LETTERS: EXPLANATORY NOTE

Last updated 27 Mar 2018

This guidance was issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales in November 2002 and updated in March 2018.

The purpose of this guidance is to remind auditors of the need to consider the reliability of written representations as audit evidence. This guidance draws attention to specific application and other explanatory material in International Standard on Auditing (ISA) (UK) 580 *Written Representations*, in order to underline the importance of ensuring that such representations are reliable. The guidance is not intended to be comprehensive and is not a substitute for the procedures or related material contained in ISA (UK) 580, or for specific measures that may be appropriate to particular matters or engagements.

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ISBN 978-1-78363-937-3

ISA (UK) 580 *WRITTEN REPRESENTATIONS*

ISA (UK) 580 requires auditors to request written representations from management with appropriate responsibilities and knowledge of the matters concerned before their report is issued. In the UK, representations are requested from the directors (or, for entities other than companies, representatives of the body charged with governance). In particular, the auditor should obtain evidence that the directors acknowledge that they have fulfilled their collective responsibility for the preparation of the financial statements and that they have approved them. ISA (UK) 580 also requires that the auditor should request representations that the directors have provided the auditor with all relevant information and access as agreed in the terms of the audit engagement, and that all transactions have been recorded and are reflected in the financial statements. The auditor also requests other representations that they determine are necessary to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

Paragraph 3 of ISA (UK) 580 states that, *Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements.* However, as paragraph 4 of ISA (UK) 580 points out, *Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.* Unsupported representations by management do not normally constitute sufficient audit evidence. The only situations where corroborative evidence may not be available are those where the subject of the representations are management judgment or intentions.

Whatever their function in the body of evidence collected by an auditor to support the audit opinion, written representations are not a mere formality. This is why ISA (UK) 580 requires the auditor to take appropriate actions if the directors do not provide one or more of the requested representations, and specifically requires the auditor to disclaim their opinion if certain representations are not provided or if they conclude that certain representations are not reliable (ISA (UK) 580 paragraph 20).

INCREASING THE USEFULNESS OF WRITTEN REPRESENTATIONS AS AUDIT EVIDENCE

A High Court decision in 2002¹ emphasised the need for auditors to consider whether the directors making representations are sufficiently well-informed to do so. In this legal case, the auditor claimed that the representations by the director were recklessly fraudulent, and therefore gave them an absolute defence of circuity against the claim in damages which they faced. The auditor's claim failed, however, because they did not establish to the judge's satisfaction that the director signed the representation letters:

- i. knowing that the statements in the letters were untrue, without an honest belief in their truth, or indifferent as to whether or not they were true;
- ii. knowing that he had no reasonable grounds for making the statements, without an honest belief that he had such grounds, or indifferent as to whether he had or not.

The judge did, however, address the issue of the result if the auditor had proved that, in signing the representation letters, the director was reckless of their truth or falsity. He concluded that, had such a case for fraudulent misrepresentation been established, he would

¹ Barings Futures Singapore v Deloitte & Touche

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have held that the company was vicariously liable for the director's action, and thus the auditor would have succeeded in their claim.

The need to consider the directors' ability to make the representations is reflected in the application guidance in ISA (UK) 580, which makes the following points (paragraphs A3 to A6):

- Due to their responsibilities for the preparation of the financial statements and the conduct of the entity's business, the directors 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 their representations
- The directors may decide to make inquiries of others, including individuals with specialised knowledge, such as internal counsel who may provide information essential to provisions for legal claims
- The directors may include qualifying language such as "to the best of our knowledge and belief", and it is normally reasonable for the auditor to accept such wording
- The auditor may request the directors to include in the representations a confirmation that they have made such inquiries as they considered appropriate to place them in the position to be able to make the requested representations.

In order to assist this process, and in particular to focus directors' attention on whether proper inquiries have been made, the auditor may find it helpful to request the directors to add a sentence to the representation letter. The illustrative representation letter in appendix 2 of ISA (UK) 580 includes the following suggestion:

We confirm that (, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

Alternatively, the auditor might consider some wording along the following lines:

We confirm that the above/following representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can properly make each of the above/following representations to you.

This wording is suggested for illustration only, and is not mandatory. It could help to reduce the impression given to directors that phrases such as *to the best of our knowledge and belief* may enable them not to make proper inquiries.

The auditor would further be well advised to ask the signatory(ies) what steps they took to obtain comfort that such an assertion had substance. In circumstances where the representations are being made by those distanced from the activities involved, for example the use of complex financial instruments, the auditor could suggest that the relevant member of management responsible provide specialised representations to the board. In this case it may be useful for the directors' own letter of representation to attach and refer to the specialist memorandum, to ensure that they retained overall responsibility.

REMINDING THE DIRECTORS OF THEIR RESPONSIBILITIES UNDER THE COMPANIES ACT 2006

Auditors may take the opportunity when discussing representations with the directors (and other staff, if applicable) to remind them of the statutory provisions relating to false or misleading statements. In particular, under section 501 of the Companies Act it is a criminal offence to knowingly or recklessly make to an auditor of a company a statement (oral or

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written) that conveys, or purports to convey, information or explanations that the auditor requires, or is entitled to require, that is misleading, false or deceptive in a material particular.

Similarly, under section 418 of the Companies Act, the directors' report is required to contain a statement that for each director, so far as they are aware, there is no relevant audit information of which the company's auditor is unaware, and they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Where this statement is false, every director who knew that it was false, or was reckless as to whether it was false, and failed to take reasonable steps to prevent the directors' report from being approved, is guilty of a criminal offence.

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