



EUROPEAN COMMISSION

Internal Market and Services DG

**FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Director**

Brussels, 23.05.07 2000
MARKT/2007/7232

Mr Jim Sylph
Technical Director
International Auditing and
Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York,
NY 10 017 – USA

**Subject: Comment on the Exposure Draft of ISA 580 (Revised and Redrafted)
– *Written Representations***

Dear Mr Sylph,

1. We appreciate the opportunity to comment on the IAASB proposal for a redrafted International Standard on Auditing on Written Representations.
2. Proposed ISA 580 (Revised and Redrafted) intends to clarify the consequences for an audit opinion if companies do not confirm their responsibilities through giving general written representations. We have the following concerns:
 - This standard appears to impose on management and those charged with governance of companies responsibilities beyond those applicable in EU jurisdictions. This affects about 5 million limited companies in Europe and the costs they have to spend on financial reporting. Paragraphs 6, 8 and 9 should be amended so as to reflect that representations' primary objective is to establish a sound basis for the audit, within the boundaries of the legal environment where the audit is performed, and based in addition, where appropriate, on terms agreed between an entity and its auditor. In particular, we recommend that the IAASB should thoroughly reconsider the approach regarding the statement of companies' (i.e. relevant parties') responsibilities on internal controls. If the final ISA 580 (Revised and Redrafted) imposes responsibilities on management and those charged with governance that extend their duties beyond those established by law and regulation, it is likely to cause a significant problem and would possibly require a cost-benefit analysis.
 - A refusal or inability on the part of relevant parties to provide general written representations might affect the audit. In such case the exposure draft requires the auditor to always disclaim an opinion. However there might be circumstances where, despite the absence of a valid general written representation, an auditor

will still be able to issue an opinion. For this reason, we suggest replacing the "automatic disclaimer" clause in paragraph 19 with a requirement that the auditor shall determine whether a disclaimer is the appropriate response.

We explain these concerns in more detail in the Annex to this letter and provide suggestions for amendments to the wording for the final ISA. We also comment on other issues.

3. I would like to emphasise that this comment letter cannot pre-empt any future official position of the European Commission. In particular, our position on the above ISA, and the objectives therein, may be modified depending on the outcome of the future revision of ISA 200 in the frame of the Clarity project.
4. The comments in this letter have taken account of the views expressed within the European Group of Auditors' Oversight Bodies (EGAOB), and/or within the 'ISA Sub-group' of the EGAOB. The ISA Sub-group is comprised of participants from European organisations including audit regulators, standard setters on auditing, professional bodies, and companies. Those comments may not necessarily reflect in all circumstances unanimous views of the members of the EGAOB and/or of the participants to the EGAOB ISA Sub-group.

Yours sincerely,



Pierre Delsaux

Cc: Jürgen Tiedje, European Commission, Members of the EGAOB.

GENERAL COMMENTS

General written representations required by ISA 580 (Revised and Redrafted) should only substantiate the responsibilities of management and/or those charged with governance as stated by the legislation in force

1. The European Commission Services are interested in setting out the fundamental pre-requisites (or 'premises') for an audit in ISAs, such as in ISA 700 and ISA 200¹. We understand the need for the auditor to confirm such pre-requisites with management, in order to ensure that an audit is performed on solid grounds. As such, ISA 580 (Revised and Redrafted) is an appropriate place to address the role of companies.
2. However, the statement of responsibilities in ISA 580, 200, 700 etc., and confirmations obtained by the auditor thereon such as in general written representation letters should not go beyond the mere confirmation of essential corporate responsibilities, as established by laws or regulations, or agreed upon between the company and the auditor. This is relevant especially in the EU, where national law and regulation establish management's responsibilities which are sufficient in substance to cover the premises on which an audit is conducted. We also believe that there should be full consistency of statements on management's responsibilities between ISAs 200, 210, 580 and 700.
3. Accordingly, ISA 580 (Revised and Redrafted) should make a step back in stating responsibilities, and should allow at the same time for the inclusion in the general written representations of items deemed appropriate by the auditor, insofar as these additions draw upon responsibilities already established by law or regulation, or have been agreed upon between the auditor and the company. One example where management's responsibility may have to be agreed upon is their commitment to provide the auditor with all the relevant information, given such responsibility might not always be established by laws or regulations in the jurisdiction.
4. The above comments entail the following consequences on paragraphs 8 and 9 of the exposure draft:
 - We understand the aim of 3rd bullet of paragraph 8 as being to confirm a company's overall responsibility to prepare financial statements in accordance with the specified framework. However, the way this bullet point tries to achieve this is not appropriate, since it requires confirmation of a limited number of items, and even envisages that some aspects might not always be applicable ("where relevant"). We suggest drafting modifications in point 15 of this letter.
 - We recommend that the IAASB should thoroughly reconsider the approach regarding the statement of relevant parties' responsibilities on internal controls. There is a great variety of approaches towards internal control, depending on the jurisdiction where an audit is performed. Whereas some jurisdictions have

¹ A draft of ISA 200 exposed until 15 September 2007 provides for a list of pre-requisites in paragraph 8. Paragraph 28 of ISA 700 and, as a result of conforming amendments, paragraph 5a of ISA 210, also states responsibilities of management.

implemented a responsibility for management of setting up internal controls, and even ensuring its effectiveness, some jurisdictions have decided to explore other avenues. In the EU, whilst Community law (Directives 2006/46/EC and 2006/43/EC) imposes on listed companies the duty to provide annually a description of the main features of internal control and risk management systems in relation to the process for preparing the financial statements, and the duty on the audit committee to monitor the effectiveness of internal control and risk management systems, the EU Member States might also in addition have added – or not – further responsibilities regarding internal control in their own jurisdiction. The landscape is therefore somehow contrasted for listed companies from one Member State to another, and certainly even more for non listed companies. For the latter, the responsibilities stated by national laws may vary significantly from one jurisdiction to another. Yet, ISAs pretend to be applicable to all types of audit, not only that of listed companies. To avoid confusion and disruptions in the conduct of statutory audits, we strongly recommend the IAASB to allow for a full reliance by the auditor on the applicable laws and regulations in relation to the responsibilities of management and/or those charged with governance with respect to internal control. Should the IAASB decide to not follow that path, inconsistencies between the wording of those laws and regulations and the wording of representations required by ISA 580 are likely to give rise to disputes as to the appropriateness of the representations being sought and a reluctance to provide the specified representations. As an aside, we suggest to modify the title of paragraph 9 into "internal control relevant to the financial statements".

General representation versus audit evidence

5. We have strong doubts whether general written representations should be regarded as audit evidence. We found no convincing explanation in the exposure draft. Written representations are valuable documentation which, if not obtained, should raise the alertness of auditors (paragraph 18 of ISA 580 (Revised and Redrafted) deals appropriately with this) and entail appropriate, proportionate reaction (paragraph 19 is too systematic in this respect).
6. As a result we suggest the following amendments:
 - to modify the wording of the Objective (see point 19 of this letter)
 - to delete in paragraph 7 the second and third sentences: "Such general written representations provide necessary audit evidence validity of the premises" and "Accordingly" at the start of the last sentence, leaving the statement "they do not relieve the auditor of the responsibility to obtain ~~other~~ audit evidence".
 - to modify paragraph 19 (see point 14 of this letter)
 - to modify the Application Material in A4 and A5 as appropriate to take account of our other recommendations.
7. We concur with IAASB's view that specific written representations should form part of the audit evidence. Given the very different nature of general versus specific representations, we agree ISA 580 (Revised and Redrafted) should clearly signal this difference and address each type separately. In the illustrative letters provided in the

ISA, general written representations should be clearly separated from specific written representation.

Auditors and companies should be able to achieve the requirements relating to General Written Representations

8. We believe that there are aspects of this section that would be difficult to implement.
9. The last part of the sentence of paragraph 6, which establishes indirectly a responsibility for relevant parties to "make appropriate enquiries for them to be able to provide representations" is problematic for general written representations. Since the relevant parties would in any case take responsibility for the general representations made, the value added by this requirement is unclear, and even confusing in such case. Such requirement might however make sense in the case of specific representations. We therefore recommend (i) moving the sentence towards the section: Specific Written representation, (ii) clarifying what constitutes "appropriate inquiries" by the relevant parties and (iii) identifying what procedures, if any, this entails for the auditor.
10. From the viewpoint of relevant parties, it may prove impossible to assert that "all transactions have been recorded" (paragraph 8, 2nd bullet point) unless some consideration is given to the materiality of such transactions. To remedy this, we suggest the possible use of communicated thresholds, as foreseen in A16, in the requirement.
11. Likewise, it may prove difficult for relevant parties to assert that "all [...] information relevant to the audit have been made available to the auditor" (paragraph 10), unless the auditor has provided prior information to the parties what is relevant to the audit. We suggest a conforming amendment to ISA 210 for the auditor to appropriately inform management what is expected from them.

ISA 580 (Revised and Redrafted) should clarify how to associate individuals with representations

12. We understand, from the definition of relevant parties and the guidance in A2, that individuals other than those with direct responsibility for the preparation and presentation of the financial statements might be invited to provide a specific written representation. If so, we believe that any such specific representation should be provided together with a representation from the relevant parties with direct responsibility for preparing and presenting the financial statements. At present, the ISA might be read as allowing such individuals to provide written representations in isolation, which runs the risk that they will not take all relevant information into consideration. To avoid the latter interpretation, we recommend a clarification of the definition.

ISA 580 (Revised and Redrafted) should allow auditors to exert professional judgement when facing shortcomings in the general representation, or no representation

13. We do not question the fact that general written representations are critical for the auditor. Auditor's response for not obtaining general written representations should be in many cases to disclaim an opinion. However, there might be circumstances

where, despite the absence of valid general written representation, an auditor might still be able to give an opinion. The auditor might have ways other than a written letter to obtain the desired confirmations. The example of a situation such as in paragraph A19 (a fire) shows clearly that paragraph 19 is not equipped to deal with all types of situation. The case of a dormant fully owned subsidiary operating in a group preparing consolidated accounts for which the auditor obtained appropriate overall representations is another example.

14. ISA 580 (Revised and Redrafted) should allow for auditors to exert professional judgement in determining whether to disclaim or, under the circumstances, not to disclaim the audit opinion. We invite the IAASB to establish the right balance between the need to disclaim an opinion and the ability for auditor to exert professional judgement. We suggest redrafting paragraph 19 along the following line: "When either the auditor concludes that the general representations are not reliable (paragraph 17) or when relevant parties do not provide the general written representation (paragraph 18), the possible effects on the financial statements of such inability are presumably pervasive unless it can be demonstrated otherwise under the circumstances. The auditor shall judge under the circumstances whether to disclaim an opinion on the financial statements in accordance with ISA 705 [...], or not." We also suggest amending paragraph 17 in order to have, instead of a statement that the premises "are not valid": the premises "may not be valid".

REQUEST FOR SPECIFIC COMMENTS

General Written Representations Regarding the Financial Statements (paragraph 8)

15. Based on our comments in points 2, 3 and 4 above, we recommend that the IAASB (i) replaces the 3rd bullet point of paragraph 8 with a more generic way of designating management's responsibilities, possibly along the lines of recognising, measuring and disclosing matters in accordance with the framework. The items listed in the 3rd bullet point might be regarded as examples of matters for specific written representations and be moved into Application Material; (ii) add in paragraph 8 that relevant parties are responsible for making accounting estimates that are reasonable in the circumstances; and (iii) provide in paragraph 8 for the flexibility to modify the confirmation on the basis of the legal environment, and to allow for the addition of items, where relevant for the audit, based on contractual obligations.

General Written Representations Regarding Internal Control (paragraph 9)

16. Paragraph 9 – and other ISAs addressing the responsibility of management and/or those charged with governance on internal control, should be thoroughly redrafted. See our comments in point 4 above.

Disclaimer of Opinion when General Written Representations are Not Obtained (paragraph 19)

17. See our comments in point 14 above.

Date of the Written Representations

18. We do not concur with the view that the representation letter should be necessarily as of the same date as the auditor's report. In our view, for the sake of practicality,

some flexibility should be offered to allow signing representation at an appropriate earlier date.

Objective and whether Requirements are appropriate answer to the objective

19. Should the IAASB decide that general written representations are not audit evidence, as we advocate, we recommend redrafting the objective using a distinct sentence for general written representations: "The objective of the auditor is to confirm (instead of "to corroborate") the validity of the premises relating to management's responsibilities".

Translations

20. The word "premises" might raise potential translation issues. It might not be possible to find a sound translation in all EU languages. We suggest replacing "premises" with "pre-requisite", or "assumption".