PKF PERSPECTIVES

THE MANAGEMENT REPRESENTATION LETTER:

Sufficient, Relevant and Reliable

Early in the 20th century in the United States, practitioners were hard pressed to get all the information needed from their clients to conduct an audit. In the 1939 book *Fifty Years of Accountancy*, Robert Montgomery, author of *Montgomery's Auditing* originally released in 1912, commented: "I recall the first time it occurred to me to ask to see the insurance policies covering the stock in process and on hand. I might as well have thrown a bomb." Mr. Montgomery said it was not unusual for auditors to be forbidden to see corporate minutes and "many a time I was refused access to subsidiary records." What a difference a century has made, with transparency being the watchword of today.

Statement on Auditing Standards (SAS) No. 19, *Client Representations*, issued by the American Institute of Certified Public Accountants (AICPA) in 1977, superceded in 1997 by SAS No. 85, *Management Representations* (as amended by SAS No. 89 and SAS No. 99), and in 2003 extended by Statement on Standards for Accounting and Review Services (SSARS) 9 to cover review engagements, mandated and provided guidance on the use of management representation letters in connection with the audit or review of financial statements.

Under current standards, the lack of an appropriately drafted and signed management representation letter could result in a scope restriction to the independent accountant and require mention in the report.

Sufficiency

During the course of an audit or review of financial statements, management generally makes representations to their independent accountants as a response to direct questions or through the financial statements. Some of their representations can be verified by the accountants through sources independent of the enterprise or independent of client management. However, written representations from client management should be obtained on matters material to the financial statements when other appropriate evidence cannot reasonably be expected to exist.

Relevancy

Independent accountants should obtain evidence that management acknowledges its responsibility for the fair presentation of the financial statements in accordance with the relevant financial reporting framework and has approved the financial statements. Representations from management should generally relate to their knowledge, understanding or intent when the independent accountant believes such representations are necessary to complement other procedures.

Reliability

Written representations should not be taken to imply warranties given by management. The signing of a representation letter by management does not alter management's responsibility; it simply affirms a responsibility that already exists. At the same time, the representation letter does not lessen the independent accountant's responsibility for the conduct of either the audit or the review.

The "Rep" Letter

Written representations from client management should be addressed to the independent accountant. The representations should be made as close to the date of the audit or review report as possible, but not earlier. The representation letter should always be signed by members of management (generally the CEO and CFO) who are responsible for and knowledgeable of, whether directly or indirectly, the financial statements and matters covered by the written representations.

The specific representations requested from management will depend on the engagement circumstances and the basis of presentation, i.e. generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (OCBOA). Typically, representations include, but are not limited to, the following for the period under audit or review:

- ❖ Acknowledgment of management's responsibility for the fair presentation of the financial statements.
- ❖ Disclosure of any irregularities or fraud involving management or employees who have a significant role in the accounting and internal control systems or that could have a material effect on the financial statements.
- ❖ Availability of all books of account and supporting documentation and all minutes of meetings of shareholders and board of directors.
- ❖ Completeness of information provided, including the identification of related parties.
- ❖ Financial statements are free of material misstatements, including omissions.
- ❖ Compliance with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.
- ❖ Proper recording and, when appropriate, adequate disclosure in the financial statements of the following:
    - ❖❖ Identity of, and balance and transactions with, related parties.
    - ❖❖ Losses arising from sale and purchase commitments.
    - ❖❖ Agreements and options to buy back assets previously sold.
    - ❖❖ Assets pledged as collateral.
- ❖ No plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.
- ❖ The effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
- ❖ The company has satisfactory title to all assets and there are no liens or encumbrances on company assets, except for those disclosed in the notes to the financial statements.
- ❖ As appropriate, all liabilities, both actual and contingent, have been recorded or disclosed; all guarantees to third parties have been disclosed in the notes to the financial statements.
- ❖ There have been no events subsequent to the period end which require adjustment of or disclosure in the financial statements or the notes thereto, except as disclosed in the notes to the financial statements.
- ❖ Legal claims have been settled and properly recorded in the financial statements. No other claims in connection with litigation have been or are expected to be received.
- ❖ There are no formal or informal compensating balance arrangements with any of the cash and investment accounts. Except as disclosed in the notes to the financial statements, there is no other line of credit arrangements.
- ❖ The capital stock repurchase options and agreements and the capital stock reserved for options, warrants, conversions and other requirements have been properly recorded or disclosed in the financial statements.
- ❖ Management's full and truthful response to all inquiries.

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