

**STATEMENT OF AUDITING STANDARDS
440
REPRESENTATIONS BY MANAGEMENT**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)**

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* HKSA 580 "Management Representations" is effective for audits of financial statements for periods beginning on or after 15 December 2004.

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*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures, (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide 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.
2. "Management" comprises officers and others who also perform senior managerial functions. Management includes directors and the audit committee only in those instances when they perform such functions.
3. In the context of this SAS, "directors" means the directors of a company, the partners, proprietors, committee of management or trustees of other forms of enterprise or equivalent persons responsible for directing the entity's operations and preparing its financial statements.

Acknowledgement by the directors of their responsibility for the financial statements

4. *The auditors should obtain evidence that the directors acknowledge their collective responsibility for preparation of the financial statements which give a true and fair view and are in accordance with the relevant financial reporting framework, and have approved the financial statements. (SAS 440.1)*
5. The auditors can obtain evidence of the directors' acknowledgement of such responsibility and approval from relevant minutes of meetings of the board of directors or similar body or by obtaining a written representation from the directors or a signed copy of the financial statements.
6. When auditors have responsibility for reporting on financial statements of a group of companies, acknowledgement by the directors of their responsibility for the preparation of the financial statements applies to both the group financial statements and the financial statements of the holding company.

Representations by management as audit evidence

7. *The auditors should obtain written representations from management on matters material to the financial statements when those representations are necessary to obtaining sufficient appropriate audit evidence. (SAS 440.2)*
8. Representations from management may be necessary to obtaining sufficient appropriate audit evidence when other evidence cannot reasonably be expected to exist as well as when other evidence does exist.

9. The possibility of misunderstandings between the auditors and management is reduced when oral representations are confirmed by management in writing. Matters which 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.
10. Written representations requested from management may be limited to matters that are considered either individually or collectively material to the financial statements. Regarding certain items it may be necessary to inform management of the auditors' understanding of materiality.
11. During the course of an audit, management makes many representations to the auditors, either unsolicited or in response to specific enquiries. When such representations relate to matters which are material to the financial statements, the auditors would:
 - 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.
12. Representations by management cannot be a substitute for other audit evidence that the auditors 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 the auditors would ordinarily expect to obtain. If the auditors are unable to obtain sufficient appropriate audit evidence regarding a matter which has, or may have, a material effect on the financial statements and such evidence is expected to be available, this will constitute a limitation of scope, even if a representation from management has been received on the matter and the auditors would consider whether to qualify their report in accordance with SAS 600 "Auditors' reports on financial statements".
13. In certain instances a representation by management may be the only audit evidence which can reasonably be expected to be available. For example, the auditors would not necessarily expect that other audit evidence would be available to corroborate management's intention to hold a specific investment for long-term appreciation.
14. When the auditors have responsibility for reporting on the financial statements of a group of companies, where appropriate they obtain written confirmation of representations regarding both the group financial statements and the financial statements of the holding company. The means by which the auditors obtain these representations depends on the group's methods of delegation of management control and authority. The auditors may be able to obtain the required representations regarding the group financial statements from management of the holding company because of the level of their involvement in the management of the group. Alternatively, the auditors may obtain certain representations regarding matters material to the group financial statements directly from the management of the subsidiary companies, or by seeking relevant representations by management to the auditors of those subsidiary companies, in addition to those obtained from management of the holding company.
15. *If a representation by management is contradicted by other audit evidence, the auditors should investigate the circumstances and, when necessary, reconsider the reliability of other representations made by management and the impact on the auditors' report in accordance with SAS 600 "Auditors' reports on financial statements". (SAS 440.3)*

Documentation of representations by management

16. The auditors 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.

17. A written representation is better audit evidence than an oral representation and can take the form of:
 - a. a representation letter from management;
 - b. a letter from the auditors outlining the auditors' 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 statements.

Basic elements of a management representation letter

18. When requesting a management representation letter, the auditors would request that it be addressed to the auditors, contain specified information and be appropriately dated and signed.
19. A management representation letter would ordinarily be dated the same date as the auditors' 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 or at a date after the date of the auditors' report, for example, on the date of a public offering.
20. 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 managing director and the finance director) based on the best of their knowledge and belief. In certain circumstances, the auditors may wish to obtain representation letters from other members of management.

Action if management refuses to provide representations

21. *If management refuses to provide a representation that the auditors consider necessary, this constitutes a scope limitation and the auditors should express a qualified opinion or a disclaimer of opinion in accordance with SAS 600 "Auditors' reports on financial statements". (SAS 440.4)*
22. In such circumstances, the auditors would evaluate any reliance placed on other representations made by management during the course of the audit and consider if the other implications of the refusal may have any additional effect on the auditors' report.

Compliance with International Standards on Auditing

23. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 580 "Management Representations".

Effective date

24. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004.

APPENDIX

Example of a management representation letter

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 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 auditors need to be aware of the limitations of management representations as audit evidence as set out in this SAS.

Entity Letterhead

(To auditors)

(Date)

Dear Sirs

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other directors and officials of the company, the following representations given to you in connection with your audit of the company's financial statements for the year ended

1. We acknowledge that the Companies Ordinance requires us to prepare financial statements which give a true and fair view of the state of affairs of the company and of the profit (loss) [and cash flows] of the company for the year. In preparing these financial statements, we have:
 - a. selected suitable accounting policies and applied them consistently;
 - b. made judgements and estimates that are prudent and reasonable;
 - c. stated the reasons for any significant departure from applicable accounting standards in Hong Kong; and
 - d. prepared the financial statements on the going concern basis.
2. We are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable us to ensure that the financial statements comply with the Companies Ordinance. We are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.
3. All of our accounting records and related data have been made available to you for the purpose of your audit and all the transactions undertaken by the company have been properly reflected and recorded in the accounting records. All other records and related information including minutes of all management and shareholders' meetings, have been made available to you.

Include here other representations relevant to the entity. Such representations may include the following:

- *There have been no irregularities 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.*
- *The financial statements are free of material misstatements, including omissions.*

- *The company has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.*
- *The following have been properly recorded and when appropriate, adequately disclosed in the financial statements:*
 - a. *the identity of, and balances and transactions with, related parties;*
 - b. *losses arising from sale and purchase commitments;*
 - c. *agreements and options to buy back assets previously sold; and*
 - d. *assets pledged as collateral.*
- *We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.*
- *We have no plans to abandon lines of products or other plans or intentions that will result in any excess or obsolete stock, and no stock is stated at an amount in excess of net realisable value.*
- *The company has satisfactory title to all assets and there are no liens or encumbrances on the company's assets, except for those that are disclosed in Note X to the financial statements.*
- *We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and have disclosed in Note X to the financial statements all guarantees that we have given to third parties.*
- *Other than described in Note X to the financial statements, there have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or Notes thereto.*
- *The claim by XYZ Company has been settled for the total sum of XXX which has been properly accrued 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 our cash and investment accounts. Except as disclosed in Note X to the financial statements, we have no other line of credit arrangements.*
- *We have properly recorded or disclosed in the financial statements the capital stock repurchase options and agreements, and capital stock reserved for options, warrants, conversions and other requirements.*
- *All reasonable steps have been taken to ensure that the financial statements comply with section 161B of the Companies Ordinance.*

(Managing Director)

(Finance Director)