1997

Proposed Statement on auditing standards : Management representations (to supersede Statement on auditing standards no. 19, Client representations, and Auditing interpretation no. 2 "Management representations when current management was not present during the period under audit") and an amendment to Statement on auditing standards no. 58, Reports on audited financial statements;Management representations (to supersede Statement on auditing standards no. 19, Client representations, and Auditing interpretation no. 2 "Management representations when current management was not present during

the period under audit") and an amendment to Statement on auditing standards no. 58, Reports on audited financial statements

American Institute of Certified Public Accountants. Auditing Standards Board

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

MANAGEMENT REPRESENTATIONS

(To Supersede Statement on Auditing Standards No. 19, *Client Representations,* and Auditing Interpretation No. 2, "Management Representations When Current Management Was Not Present During the Period Under Audit")

AND AN AMENDMENT TO STATEMENT ON AUDITING STANDARDS NO. 58, *REPORTS ON AUDITED FINANCIAL STATEMENTS*

JUNE 9, 1997

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and attestation issues

Comments should be received by August 15, 1997, and addressed to
Kim M. Gibson, Technical Manager, Audit and Attest Standards, File 4308,
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775
or via the Internet to KGIBSON@AICPA.ORG

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Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881. This document is also available on AICPA Online at http://www.aicpa.org.

June 9, 1997

Accompanying this letter is an exposure draft, approved by the Auditing Standards Board (ASB), of a proposed Statement on Auditing Standards (SAS) entitled *Management Representations.* This proposed Statement would supersede SAS No. 19, *Client Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333), and Auditing Interpretation No. 2, "Management Representations When Current Management Was Not Present During the Period Under Audit" (AICPA, *Professional Standards*, vol. 1, AU sec. 9333). This exposure draft also would amend SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol 1, AU sec. 508.71). A summary of the significant provisions of the proposed Statement accompanies this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the ASB's consideration of responses, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

In developing guidance, the ASB considers the relationship between the cost imposed and the benefits reasonably expected to be derived from audits. It also considers the differences the auditor may encounter in the audit of financial statements of small businesses and, when appropriate, makes special provisions to meet those needs. Thus, the ASB would particularly appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of AICPA Audit and Attest Standards and will be available for public inspection at the offices of the AICPA after August 18, 1997, for one year. Comment letters should be sent to Kim M. Gibson, Technical Manager, Audit and Attest Standards, File 4308, AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775 in time to be received by August 15, 1997. Comments also may be sent by electronic mail over the Internet to KGIBSON@AICPA.ORG.

Sincerely,

Edmund R. Noonan
Chair
Auditing Standards Board

Thomas Ray
Director
Audit and Attest Standards

Auditing Standards Board
(1997)

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SUMMARY

WHY ISSUED

The Auditing Standards Board (ASB) has issued this exposure draft to provide appropriate guidance regarding written management representations to be obtained by an auditor as part of an audit performed in accordance with generally accepted auditing standards. A task force of the ASB reviewed Statement on Auditing Standards (SAS) No. 19, *Client Representations* (AICPA, *Professional Standards*, AU sec. 333), and determined that it needed to be updated to reflect changes in auditing practice and the auditing environment since SAS No. 19 was issued. This proposed Statement would supersede SAS No. 19.

This proposed Statement—

- Clarifies the requirement for an auditor to obtain written representations for all financial statements and periods covered by the auditor's report.

- Includes a representation made by management that states that it is management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles.

- Includes a list of updated specific representations to be obtained from management that are consistent with representations obtained in current practice. Such representations include information concerning fraud as referred to in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316) and significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.

- States that the auditor ordinarily should obtain a representation letter tailored to cover representations relating to the financial statements unique to the entity's business or industry. Also, appendix B, "Additional Representations," has been added to the proposed Statement and includes additional representations that may be appropriate in certain situations.

- Requires the auditor to investigate the circumstances and consider the reliability of a representation made, if that representation is contradicted by other audit evidence.

- Includes guidance regarding materiality levels that may be stated explicitly in the representation letter, in either qualitative or quantitative terms. Also, the illustrative management representation letter included in appendix A, "Illustrative Management Representation Letter," includes a qualitative discussion of materiality.

- Includes guidance for circumstances when an auditor should obtain an updated representation letter from management such as when a predecessor auditor is requested by a former client to reissue his or her report on the financial statements of a prior period. Also, an illustrative updating management representation letter has been added to the proposed Statement in appendix C, "Illustrative Updating Management Representation Letter."

Proposed Amendment to SAS No. 58, *Reports on Audited Financial Statements*

This exposure draft contains a proposed revision to SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol 1, AU sec. 508.71), which would expand a predecessor auditor's procedures when asked by a former client to reissue his or her report on the financial statements of a prior period. This proposed amendment would require the predecessor auditor to obtain a letter of representation from management, in addition to the representation letter from the successor auditor, before reissuing a report previously issued on financial statements of a prior period. See the section herein entitled, "Proposed Amendment to Statement on Auditing Standards No. 58, *Reports on Audited Financial Statements*."

In conjunction with the proposed amendment to SAS No. 58, an illustrative updating management representation letter is included as appendix C, "Illustrative Updating Management Representation Letter," of the proposed Statement.

HOW IT AFFECTS EXISTING STANDARDS

This proposed Statement would supersede SAS No. 19 and Auditing Interpretation No. 2, "Management Representations When Current Management Was Not Present During the Period Under Audit" (AICPA, *Professional Standards*, vol. 1, AU sec. 9333). It also would amend SAS No. 58.

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PROPOSED STATEMENT ON AUDITING STANDARDS

MANAGEMENT REPRESENTATIONS

INTRODUCTION

1. This section establishes a requirement that the independent auditor obtain written representations from management as a part of an audit performed in accordance with generally accepted auditing standards and provides guidance concerning the representations to be obtained.

RELIANCE ON MANAGEMENT REPRESENTATIONS

2. During an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for the opinion on the financial statements. Written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.[1]

3. The auditor obtains written representations from management to complement other auditing procedures. In many cases, the auditor applies auditing procedures specifically designed to obtain evidential matter concerning matters that also are the subject of written representations. For example, after the auditor performs the procedures prescribed in Statement on Auditing Standards (SAS) No. 45, *Related Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 334), even if the results of those procedures indicate that transactions with related parties have been properly disclosed, he or she ordinarily should obtain a written representation to document that management has no knowledge of any such transactions that have not been properly disclosed. In some circumstances, evidential matter that can be obtained by the application of auditing procedures other than inquiry is limited; therefore, the auditor obtains written representations to provide additional evidential matter. For example, if a client plans to discontinue a line of business and the auditor is not able to obtain sufficient information through other auditing procedures to corroborate the plan or intent, the auditor obtains a written representation to provide evidence of management's intent.

4. If a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made. Based on the circumstances, the auditor should consider whether his or her reliance on management's representations relating to other aspects of the financial statements is appropriate and justified.

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[1] Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit*, appendix B, "Amendment to *Due Professional Care in the Performance of Work*" (AICPA, *Professional Standards*, vol. 1, AU sec. 316), states, "The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest."

OBTAINING WRITTEN REPRESENTATIONS

5. Written representations from management should be obtained for all financial statements and periods covered by the auditor's report.[2] For example, when reporting on comparative financial statements, the written representations obtained at the completion of the most recent audit should address all periods reported on.

6. The specific written representations obtained by the auditor will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements.[3] Specific representations ordinarily relate to the following matters:

Financial statements

a. Management's acknowledgment of its responsibility for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.
b. Management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles.

Completeness of information

c. Availability of all financial records and related data.
d. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors.
e. Communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.
f. Absence of unrecorded transactions.

Recognition, measurement, and disclosure

g. Information concerning fraud involving (i) management, (ii) employees who have significant roles in internal control, or (iii) others where the fraud could have a material effect on the financial statements.
h. Plans or intentions that may affect the carrying value or classification of assets or liabilities.
i. Information concerning related-party transactions and amounts receivable from or payable to related parties.[4]
j. Guarantees, whether written or oral, under which the company is contingently liable.
k. All significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.
l. Violations or possible violations of laws or regulations whose effects should be considered for

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[2] An illustrative representation letter from management is contained in appendix A, "Illustrative Management Representation Letter."

[3] Specific representations also are applicable to financial statements presented in conformity with a comprehensive basis of accounting other than generally accepted accounting principles; references in this Statement to financial statements presented in conformity with generally accepted accounting principles also include those presentations.

[4] See SAS No. 45, *Related Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 334).

disclosure in the financial statements or as a basis for recording a loss contingency.[5]

m. Unasserted claims or assessments that the entity's lawyer has advised are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.[6]
n. Other liabilities and gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.[7]
o. Satisfactory title to assets, liens on assets, and assets pledged as collateral.
p. Compliance with aspects of contractual agreements that may affect the financial statements.

Subsequent events

q. Information concerning subsequent events.[8]

7. The representation letter ordinarily should be tailored to cover representations relating to the financial statements that are unique to the entity's business or industry. Accordingly, based on the circumstances of the engagement, the auditor should obtain additional appropriate representations from management acknowledging issues specific to the entity's business or industry.[9] Examples of additional representations that may be appropriate are provided in appendix B, "Additional Representations."

8. Management's representations may be limited to matters that are considered either individually or collectively material to the financial statements, provided management and the auditor have reached an understanding on the limits of materiality for this purpose. This materiality level may be stated explicitly in the representation letter, in either qualitative or quantitative terms. Such limitations would not apply to those representations that are not directly related to amounts included in the financial statements, for example, items (a), (c), and (d) above. In addition, because of the possible effects of fraud on other aspects of the audit, a materiality limit would not apply to item (g) above with respect to management or those employees who have significant roles in internal control.

9. The written representations should be addressed to the auditor. Because the auditor is concerned with events occurring through the date of his or her report that may require adjustment to or disclosure in the financial statements, the representations should be made as of a date no earlier than

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[5] See SAS No. 54, *Illegal Acts By Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317).

[6] See SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* (AICPA, *Professional Standards*, vol 1, AU sec. 337.05d). If the client has not consulted a lawyer regarding litigation, claims, and assessments, the auditor normally would rely on the review of internally available information and obtain a written representation by management regarding the lack of litigation, claims, and assessments; see Auditing Interpretation No. 6, "Client Has Not Consulted a Lawyer." (AICPA, *Professional Standards*, vol. 1, AU sec. 9337).

[7] See SAS No. 12, AU sec 337.05b).

[8] See SAS No. 1, *Codification of Auditing Standards and Procedures,* the section entitled "Subsequent Events," (AICPA, *Professional Standards*, vol. 1, AU sec. 560.12), and SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711.10).

[9] Certain AICPA Audit Guides require or recommend that the auditor obtain written representations concerning matters that are unique to a particular industry. This section does not supersede those requirements or recommendations.

the auditor's report. The letter should be signed by those members of management with overall responsibility for financial and operating matters whom the auditor believes are responsible for and knowledgeable about, directly or through others in the organization, the matters covered by the representations. Such members of management normally include the chief executive officer and chief financial officer or others with equivalent positions in the entity.

10. There are circumstances in which an auditor should obtain updated representation letters from management. For example, if a predecessor auditor is requested by a former client to reissue his or her report on the financial statements of a prior period, the predecessor auditor should obtain a letter of representations from the management of the former client stating whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on that would require adjustment to or disclosure in the financial statements reported on by the predecessor auditor.[10] Also, when performing subsequent events procedures in connection with filings under the Securities Act of 1933, the auditor should obtain certain written representations.[11]

11. If current management was not present during all periods covered by the auditor's report, the auditor should nevertheless obtain written representations from current management on all such periods. The specific written representations obtained by the auditor will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. As discussed in paragraph 8, management's representations may be limited to matters that are considered either individually or collectively material to the financial statements.

12. In certain circumstances, the auditor may want to obtain written representations from other individuals. For example, he or she may want to obtain written representations about the completeness of the minutes of the meetings of stockholders, directors, and committees of directors from the person responsible for keeping such minutes. Also, if the ~~independent~~ auditor performs an audit of the financial statements of a subsidiary but does not audit those of the parent company, he or she may want to obtain representations from management of the parent company concerning matters that may affect the subsidiary, such as related-party transactions or the parent company's intention to provide continuing financial support to the subsidiary.

SCOPE LIMITATIONS

13. Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion.[12] Further, the auditor should consider the effects of the refusal on his or her ability to rely on other management representations.

14. If the auditor is precluded from performing procedures he or she considers necessary in the circumstances with respect to a matter that is material to the financial statements, even though management has given representations concerning the matter, there is a limitation on the scope of

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[10] See SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec.508.71) as amended by this Statement. An illustrative updating management representation letter is contained in appendix C, "Illustrative Updating Management Representation Letter."

[11] See SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol 1, AU sec. 711.10).

[12] See SAS No. 58, the section entitled "Scope Limitations" (AU sec. 508.22 - .34).

the audit, and the auditor should qualify his or her opinion or disclaim an opinion.

EFFECTIVE DATE

15. This Statement will be effective for audits made in accordance with generally accepted auditing standards for periods ending on or after June 30, 1998. Earlier application of the provisions of this Statement is permissible.

APPENDIX A

ILLUSTRATIVE MANAGEMENT REPRESENTATION LETTER

1. The following letter is presented for illustrative purposes only. The introductory paragraph should specify the financial statements and periods covered by the auditor's report, for example, "balance sheets of XYZ Company as of December 31, 19X1 and 19X0, and the related statements of income and retained earnings and cash flows for the years then ended." The written representations to be obtained should be based on the circumstances of the engagement and the nature and basis of presentation of the financial statements being audited. (See appendix B, "Additional Representations.")

2. If matters exist that should be disclosed to the auditor, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred..." Similarly, in appropriate circumstances, item 6 could be modified as follows: "We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of segment A, as disclosed in footnote X to the financial statements, which are discussed in the minutes of the December 7, 19X1, meeting of the board of directors."

3. The qualitative discussion of materiality used in the illustrative letter is adapted from Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.

4. Certain terms are used in the illustrative letter that are described elsewhere in authoritative literature. Examples are fraud, in Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316) and related parties, in SAS No. 45, *Related Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 334, footnote 1). To avoid misunderstanding concerning the meaning of such terms, the auditor may wish to furnish those definitions to management or request that the definitions be included in the written representations.

5. The illustrative letter assumes that management and the auditor have reached an understanding on the limits of materiality for purposes of the written representations. However, it should be noted that a materiality limit would not apply for certain representations, as explained in paragraph 8 of this Statement.

6.

[*Date*]

To [*Independent Auditor*]

We are providing this letter in connection with your audit(s) of the [*identification of financial statements*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of expressing an opinion as to whether the [*consolidated*] financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of [*name of client*] in conformity with generally accepted accounting principles [*other comprehensive basis of accounting*]. We confirm that we are responsible for the fair presentation in the [*consolidated*] financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, [*as of (date of auditor's report),*] the following representations made to you during your audit.

1. The financial statements referred to above are fairly presented in conformity with generally accepted accounting principles.
2. We have made available to you all–
   a. Financial records and related data.
   b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There has been no communication from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
5. There has been no–
   a. Fraud involving management or employees who have significant roles in internal control.
   b. Fraud involving others that could have a material effect on the financial statements.
6. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
7. The following have been properly recorded or disclosed in the financial statements:
   a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
   b. Guarantees, whether written or oral, under which the company is contingently liable.

that

c. All significant estimates and material concentrations known to management that are to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties.* [*Significant estimates are estimates at the balance sheet date ~~which~~ could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events could occur which would significantly disrupt normal finances within the next year.*]

8. There are no–
   a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
   b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies.*[1]
   c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.
9. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.
10. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

[*Add additional representations that are unique to the entity's business or industry. See paragraph 7 and appendix B, "Additional Representations," of this Statement.*]

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

____

[*Name of Chief Executive Officer and Title*]

____

[*Name of Chief Financial Officer and Title*]

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[1] In the circumstance discussed in footnote 6 of this Statement, this representation might be orded as follows:

We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board Statement No. 5, *Accounting for Contingencies,* and we have not consulted a lawyer concerning litigation, claims, or assessments.

APPENDIX B

ADDITIONAL REPRESENTATIONS

1. As discussed in paragraph 7 of this Statement, representation letters ordinarily should be tailored to cover representations that are unique to the entity's business or industry. The auditor also should be aware that certain AICPA Audit Guides require or recommend that the auditor obtain written representations concerning matters that are unique to a particular industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The auditor also should consider the effects of pronouncements issued subsequent to the issuance of this Statement.

GENERAL

Condition	***Illustrative Example***
Unaudited interim information accompanies the financial statements.	The unaudited interim financial information accompanying [*presented in Note x to*] the financial statements for the [*identify all related periods*] has been prepared and presented in conformity with generally accepted accounting principles applicable to interim financial information [*and with Item 302(a) of Regulation S-K*]. The accounting principles used to prepare the unaudited interim financial information are consistent with those used to prepare the audited financial statements.
The impact of a new accounting principle is not known.	The entity has not completed the process of evaluating the impact that will result from adopting Financial Accounting Standards Board (FASB) Statement No. ...[*XXX, Name*] *as* discussed in Note [*X*]. The Company is therefore unable to disclose the impact that adopting FASB Statement No. [*XXX*] will have on its financial position and the results of operations when such Statement is adopted.
There is justification for a change in accounting principles.	The entity believes that [*describe the newly adopted accounting principle*] is preferable to [*describe the former accounting principle*] because [*describe management's justification for the change in accounting principles*].
Financial circumstances are strained, with disclosure of management's intentions and the company's ability to continue as a going concern.	Note [*X*] to the financial statements discloses all of the facts (meaning, significant conditions and events, and management plans) of which we are aware that are relevant to the entity's ability to continue as a going concern.

The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired and the recovery of their carrying costs is uncertain.	The entity has reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The work of a specialist has been used by the entity.	We agree with the work of specialists in evaluating the [*describe assertion*] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give nor cause any instructions to be given to specialists with respect to the values or amounts derived, and we are not aware of any matters that have had impact on the independence or objectivity of the specialists.

ASSETS

Condition	***Illustrative Example***
Cash	
Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, line of credit or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit or similar arrangements have been properly disclosed.
Financial Instruments	
Management intends to, and has the ability to, hold to maturity debt securities classified as held-to-maturity.	Debt securities that have been classified as held-to-maturity have been so classified due to management's intent to hold such securities to maturity and the entity's ability to do so. All other debt securities have been classified as available-for-sale.
There is a temporary decline in the value of debt or equity securities.	Management considers the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.
Management has estimated the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to estimate fair values of financial instruments are as follows: [*describe methods and significant assumptions used to estimate fair values of financial instruments*]. The methods and significant assumptions used result in a measure of fair value appropriate for financial measurement and disclosure purposes.

There are financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk have been properly disclosed in the financial statements: (a) the extent, nature, and terms of financial instruments with off-balance-sheet risk, (b) the amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments, and (c) significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments.

Receivables

Receivables have been recorded in the financial statements.	Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.

Inventories

Excess or obsolete inventories exist.	Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.

Investments

There are unusual considerations involved in determining the application of equity accounting.	[*For investments in common stock that are either nonmarketable or of which the Company has a 20 percent or greater ownership interest, select the appropriate representation from the following:*] • The equity method is used to account for the Company's investment in the common stock of [*investee*] because the Company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the Company's investment in the common stock of [*investee*] because the Company does not have the ability to exercise significant influence over the investee's operating and financial policies.

Deferred Charges

Material expenditures have been deferred.	Management believes that all material expenditures that have been deferred to future periods will be recoverable.

Deferred Tax Assets

A deferred tax asset exists at the balance-sheet date.	The entity is responsible for determining the amount of the deferred tax asset valuation allowance. The valuation allowance has been determined pursuant to the provisions of FASB Statement No. 109, *Accounting for Income Taxes,* including the entity's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [*Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.*] **or** A valuation allowance against deferred tax assets at the balance-sheet date is not considered necessary.

LIABILITIES

Condition	***Illustrative Example***
Debt	
Short-term debt could be refinanced on a long-term basis and management intends to do so.	The entity has excluded short-term obligations totaling $[*amount*] from current liabilities because the entity intends to refinance the obligation on a long-term basis. [*Complete with appropriate wording detailing how amounts will be refinanced as follows:*] ● The entity has issued a long-term obligation [debt security] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis. ● The entity has the ability to consummate the refinancing, when considered necessary, by using the financing agreement referred to in Note [*X*] to the financial statements.
Tax-exempt bonds have been issued.	Tax-exempt bonds issued have retained their tax-exempt status.

Taxes

Management intends to reinvest undistributed earnings of a foreign subsidiary.	Management has a specific intention to reinvest the undistributed earnings of a foreign subsidiary.

Contingencies

Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.	Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [*name of site*]. We believe that this estimate accurately represents available information and that it has been adequately described in the entity's financial statements.
Agreements may exist to repurchase assets previously sold.	Agreements to repurchase assets previously sold have been properly disclosed.

Pension and Postretirement Benefits

An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
There is involvement with a multiemployer plan.	Management is unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan.
Postretirement benefits have been eliminated.	Management does not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits.
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefits obligations.	The entity plans to continue to (or not) make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost.

EQUITY

Condition	*Illustrative Example*
There are capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

INCOME STATEMENT

Condition	*Illustrative Example*
There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.
There may be losses from purchase commitments for inventory quantities at prices in excess of market.	Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of the normal requirements or at prices in excess of the prevailing market prices.

APPENDIX C

ILLUSTRATIVE UPDATING MANAGEMENT REPRESENTATION LETTER

1. The following letter is presented for illustrative purposes only. It may be used if a predecessor auditor is requested by a former client to reissue his or her report on the financial statements of a prior period. Management need not repeat all of the representations made in the previous representation letter.

2. If matters exist that should be disclosed to the auditor, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred..."

3.

[*Date*]

To [*Auditor*]

In connection with your audit of the [*identification of financial statements*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of expressing an opinion as to whether the [*consolidated*] financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of [*name of client*] in conformity with generally accepted accounting principles, you were previously provided with a letter of representations under date of [*date of previous representation letter*].

To the best of our knowledge and belief, no events have occurred subsequent to [*date of latest prior-period balance sheet reported on by the predecessor auditor*] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

____

[*Name of Chief Executive Officer and Title*]

____

[*Name of Chief Financial Officer and Title*]

Appendix D

PROPOSED AMENDMENT TO STATEMENT ON AUDITING STANDARDS (SAS) NO. 58,
REPORTS ON AUDITED FINANCIAL STATEMENTS

Amends Statement on Auditing Standards No. 58,
AICPA, *Professional Standards*, vol. 1, AU sec. 508.71

[*Explanation*]

This amendment requires the predecessor auditor to obtain a letter of representation from management, in addition to the representation letter from the successor auditor, before reissuing a report previously issued on financial statements of a prior period. New language is shown in boldface; deleted language is shown by strike-through. The amendment is effective for reports reissued on or after June 30, 1998. Earlier application of the provisions of this amendment is permissible.

[*Text of Proposed Change*]

71. Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, a predecessor auditor should consider whether his previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor's previous report inappropriate. Consequently, a predecessor auditor should (a) read the financial statements of the current period, (b) compare the prior-period financial statements that he reported on with the financial statements to be presented for comparative purposes, and (c) obtain a letters of representations from **management of the former client and from** the successor auditor. **The letter of representations from management of the former client should state whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.**[27] The letter of representations **from the successor auditor** should state whether the successor's audit revealed any matters that, in the successor's opinion, might have a material effect on, or required disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider the matters described in section 543, *Part of Audit Performed by Other Independent Auditors*, paragraphs 10 through 12. However, the predecessor auditor should not refer in his reissued report to the report or work of the successor auditor. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 79, December 1995.]

[27] **See SAS No. XX, *Management Representations*, appendix C, "Illustrative Updating Management Representation Letter."**