TECHNICAL STAFF BRIEFING PAPER

Subject: APES GN 41 *Management Representation Letters*

Project Objective:

The objective of the project is to assist Members in Business who are Chief Finance Officers (CFOs) or in an equivalent role in understanding the contents, implications and responsibilities associated with signing management representation letters for their employer entity.

Background:

Prior to the release of APES GN 40 *Ethical Conflicts in the Workplace – Consideration for Members in Business* (APES GN 40) in May 2012, APESB's engagement with Members in Business indicated that there were low levels of awareness of APESB pronouncements within the business community. This was partly due to the focus of the previous professional pronouncements being on Members in Public Practice rather than on Members in Business. The release of APES GN 40 raised awareness of APESB pronouncements with Members in Business and provided a greater understanding of Part C of APES 110 *Code of Ethics for Professional Accountants* (the Code).

During the development of APES GN 40, the Board identified the need for guidance on management representation letter for Members in Business. Members in Business are commonly required to sign such representations as part of the year-end reporting responsibilities (both statutorily and by convention in some entities) and will benefit from a greater understanding of the contents, implications and responsibilities associated with doing so, particularly in the case of a consolidated group with a large number of subsidiaries which may be based in multiple countries. Where there are subsidiaries, the Group CFO (or equivalent officer) is likely to rely on the representations of the CFOs/Financial Controllers of subsidiaries when making the group representation to the Board and/or the external auditor.

Some international developments and topics of interest to Members in Business include:

- The role and expectations of a CFO – A global debate on preparing accountants for finance leadership[1]
- The evolving role of today's CFO – An Americas supplement to the DNA of the CFO - EY[2]
- The changing role of the CFO - ACCA[3]

Definition of Written Representations:

Written representation means a statement by management provided to those charged with governance and/or the external auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include the financial report, the assertions therein, or supporting books and records.[4]

---

[1] https://www.ifac.org/sites/default/files/publications/files/Role%20of%20the%20CFO.pdf
[2] http://www.ey.com.au/Publication/vwLUAssets/Americas_CFO_ViewsVisionInsights_062012/$FILE/Americas_CFO_ViewsVisionInsights_062012.pdf
[3] http://www.accaglobal.com/content/dam/acca/global/PDF-technical/finance-transformation/pol-afb-croc.pdf
[4] Auditing Standard ASA 580 Written Representations (Amended and compiled July 2013)

"Strawman" of the matters to be addressed in the proposed APES GN 41

The proposed APES GN 41 should address matters in respect of fundamental responsibilities of Members in Business who are CFOs (or equivalent) and to assist CFOs in understanding the contents of and implications associated with signing management representation letters for their employer:

<u>Fundamental responsibilities of Members in Business</u>

This section could follow the approach of APES GN 40 with Members in Business referred to the fundamental principles in the Code for all Members and Part C for responsibilities and requirements specific to Members in Business.

<u>Subject matters a CFO will have to consider in making management representation include:</u>

1. The management control environment
    - Safeguards in the work environment (i.e. systems of corporate oversight, ethics and conduct programs, recruitment procedures, strong internal controls, appropriate disciplinary processes) to eliminate the threats of compliance with the fundamental principles created by the conflicts of interest, incentives, business and family relationships etc. ***(refer sections 300 & 310 of the Code)***
    - Consider the organisation's entity-level controls in assessing and monitoring the adequacy of safeguards over the control environment, information systems and processes and whether the existing corporate governance and risk management frameworks are appropriate.
    - Consider issues/problems that have arisen in the financial, compliance or operational control environment and the impact of any deficiencies on the internal control environment, or on the business and the resulting impact on the financial statements.
    - Does the CFO have sufficient knowledge of the conduct of the Company's business and financial processes?[5]
2. Legislative, regulatory compliance and professional and ethical obligations
    - Assessment of the organisation's compliance with regulatory requirements or company policies.
    - Consider aspects of law, regulations and contractual agreements that may affect the financial report, including non-compliance.[4]
    - Compliance with professional & ethical obligations in the Code and in particular ***section 320 of the Code*** when preparing and reporting information.
    - Considerations specific to public sector entities whereby written representations confirm that transactions and events have been carried out in accordance with statutory requirements.[4]
3. Accounting records and controls
    - Has the organisation fulfilled its responsibility for the preparation of the financial report in accordance with the applicable financial reporting framework and ensured access and completeness of the information provided to the auditor?[4]
    - Has the organisation recorded and reflected all transactions in the financial report and maintained financial records, registers and minutes? [4] **(*refer section 320 of the Code)***
    - Has the organisation addressed accounting and financial reporting risk that a material misstatement in the financial statements would not be prevented or detected in a timely manner?
    - Has the organisation considered significant issues, estimates and judgements that may have a material impact on the financial statements?
    - Has the organisation considered the selection and application of appropriate accounting policies?
    - Review the management controls over the financial statement close process.

[5] Financial reporting certification-A practical guide to implementing and enhancing the process supporting the Corporations Act 2001 and Principle 7.3 certification (revised) June 2010

4. Fraud and irregularities
    - Assessment of the risks of fraud and implemented internal controls designed to prevent and detect fraud such as segregation of duties and internal audit.
    - Ongoing evaluation of the possibility of fraud, errors, non-compliance and corruption risk which covers the whole group, company and specific business units.
    - Ongoing review of internal controls and the structure of internal audit to evaluate its effectiveness.[6]
    - In the event a fraud is encountered, obtaining professional advice from the relevant professional body or legal advisors on the issues without breaching the fundamental principle of confidentiality.
5. External and internal audit findings
    - Review external and internal audit findings and implement corrective or remedial action where necessary.
6. Assessment of all assets and liabilities reflected in the financial statements
    - Ensure the appropriate disclosure of all assets and liabilities in the financial statements and appropriate use of corporate assets.
    - Describe clearly the true nature of the organisation's transactions, assets and liabilities.
    - Consider title to or control over assets, liens or encumbrances on assets and assets pledged as collateral.
7. Potential write-offs
    - Consideration of plans or future intentions of management that may affect the carrying value or classification of assets and liabilities.[4]
    - Assessment of recoverable amounts of debts and impairment of assets.
8. Commitments and contingencies
    - Assessment of actual and contingent liabilities, capital commitments and operating commitments are recognised, measured, presented or disclosed in accordance with the relevant applicable financial reporting framework.[4]
    - Where applicable, consideration of the estimates and disclosures of environmental remediation liabilities, agreement to repurchase assets previously sold, pension and post-retirement benefits.
9. Subsequent events
    - Consideration of the estimates and disclosures of subsequent events occurring after reporting date e.g. employee layoffs, significant estimates and material concentrations known to management that are required to be disclosed.[7]
10. The process to collate the management representation letters from subsidiaries
    - Possess sufficient knowledge of the process followed by the subsidiaries in preparing and presenting the financial report.[4]
    - Possess sufficient knowledge, expertise or experience of subsidiaries' activities and consider the level of expertise or experience possessed by subsidiaries' CFOs. ***(section 330 of the Code)***
    - Consider the competence, integrity, ethical values or diligence of subsidiaries' management on its commitment to or enforcement of subsidiaries' control environment to ensure that the risk of management misrepresentation in the financial report is minimal.[4]
    - Consider whether the CFOs of subsidiaries understand their responsibilities in respect of the management representation letter provided to the parent entity, the importance of ensuring that the representation is reliable and what it is they are being asked to confirm.
    - Acknowledge their collective responsibility for the preparation of the subsidiaries' financial statements and understand that they retain the overall responsibility for the management representation letter of their respective subsidiaries.

---

[6] http://www.bakertilly.com/insights/fraud-who-is-responsible

[7] http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00333.pdf

- The extent to which procedures are in place to test or verify the assertions and representations made at subsidiary level, such that the CEO can demonstrate reliance can be placed on the process
- The responses made to "negative" assertions and representations within the organisation and the process for resolving and reporting such matters, where material, to those charged with governance.

Importance of management representation letter to auditors:

- Management is responsible for assertions in the financial statements (e.g. existence of inventory, collectability of receivables, proper recording of liabilities).
- Auditors use representation letters to document management responses to certain inquiries made during the audit and use these representations to complement other auditing procedures and to provide additional evidential matter.

Implications associated with signing management representation letters for their employer include:

- The view of the auditing profession in Australia that it is management's role to detect financial fraud and that the detection of fraud by auditors is seen as being secondary to the primary duty of reporting whether the accounts are 'true and fair' (Gay and Pound 1989). For example, paragraph 7 of AUSI (see Parker 1991) provides as follows:

  > While the auditor is responsible for forming and expressing an opinion on the financial information, the responsibility for its preparation lies with the management of the entity. Management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of appropriate accounting policies, and the safeguarding of the assets of the entity. The audit of the financial information does not relieve management of its responsibilities (see further Godsell 1990, p. 121).[8]

- Auditing Standard ASA 580 *Written Representations* is a legislative instrument under the *Legislative Instruments Act 2003*. Hence, if management do not provide management representation letters, the auditor has a regulatory obligation to report the matter.[9]

- Statutory provisions or Criminal offence under sections 1308[10] and 1311[11] of the *Corporations Act 2001* for an officer of a Company to knowingly or recklessly make a false or misleading material statement or omits any matter or thing to the person's knowledge is misleading in a material respect, in a document required by or for the purposes of the *Corporations Act 2001*.
  - Section 1308: Provision on false or misleading statements
  - Section 1311: General penalty provisions for contravention of provisions of the *Corporations Act 2001*

- Sarbanes-Oxley Act of 2002 requires the CEO and CFO of publicly traded companies to issue a statement certifying that the accompanying financial statements and disclosures fairly present, in all material respects, the operations and financial conditions of the Company in addition to auditor's Management Representation Letter. The CEO and CFO could face significant penalties if they certify that the Company's financial records are accurate when they are not, as well as being barred by the SEC from ever serving as a corporate officer or director.[12]

---

[8] http://www.aic.gov.au/media_library/publications/proceedings/10/tomasic.pdf
[9] http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s990k.html
[10] http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1308.html
[11] http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s1311.html
[12] http://www.nysscpa.org/cpajournal/2003/0703/features/f073603.htm

Appendix 1 – Stakeholders engaged by the CFO and key issues

Stakeholders the CFO will engage with:

- CEO
- Board of directors
- Senior management of the organisation
- Divisional financial controllers and finance staff
- Audit committees
- Due diligence committees
- External audit
- Internal audit
- Shareholders/investors
- Treasury
- IT Function
- Regulators and policy makers
- Bank syndicates
- Employees

CFO's role – key matters and conflicting priorities

- According to the auditing standards, the primary responsibility of the prevention and detection of fraud tests rests with the governing body and management.
- Establishment of an ethical, technical mindset together with business acumen and corporate governance.
- Expectations of CFO's management representation change over time and are influenced by various external and internal drivers that affect organisational circumstances and requirements.
- CFO's oversight responsibility for other organisational functions and aspects such as infrastructure management, IT, human resources and payroll, operational responsibilities and administration.
- Unrealistic expectations of external auditors and to bridge the gap between public expectations and the view of management concerning their responsibilities.
- Management to exercise professional scepticism. Fraud prevention and detection necessitate an ever-changing, multi-faceted process.
- CFO's management support role to the Chief Executive (CEO).
- CFO's stated/unstated role to the Board as an officer of the company.
- Potential for CFO to be active simultaneously as management, executive director and Board member.
- Significant issues, estimates and judgements may create controversy among members of management team (i.e. if the end result has an impact on management incentives), internal or external auditors or in circumstances where there may be a lack of authoritative guidance or consensus in practice. ***(refer section 340 of the Code).***
- Internal audit to be structured so that they report directly to the Audit Committee or the Board of Directors.