



Exposure Draft

Proposed Joint Policy Statement



Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements

November 2014

COMMENTS TO THE AASB AND THE CBA COMMITTEE MUST BE RECEIVED BY APRIL 6, 2015

Please send comments via email (in Word format), to:

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This Exposure Draft reflects proposals made by the Auditing and Assurance Standards Board (AASB) and the JPS Review Committee of The Canadian Bar Association (CBA Committee).

All comments received by the AASB and the CBA Committee will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

Highlights

Introduction

The Auditing and Assurance Standards Board (AASB) and the JPS Review Committee of the Canadian Bar Association (CBA Committee) propose, subject to comments received following exposure and subsequent approval by the AASB and CBA Council, to issue a revised “Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements” (the “Statement”). This Statement will replace:

- the [existing Statement](#), with the same title; and
- Assurance and Related Services Guideline, [AuG-46, Communication with Law Firms under New Accounting and Auditing Standards](#) (often known to lawyers as the “Interim Guidance”).

The proposed revised Statement has been written from the perspectives of both the AASB and the CBA Committee and, therefore, contains terminology and concepts from both the auditing and legal professions.

Appendix II proposes changes to Canadian Auditing Standards (CAS) 501, *Audit Evidence — Specific Considerations for Selected Items*, in the CPA Handbook – Assurance, which would be relevant to those who apply Canadian Auditing Standards.

Background

The method of communication among management, the auditor and the law firm with respect to claims and possible claims as part of the auditor’s examination of financial statements has been guided by the existing Statement since 1978. In early 2009, the AASB and the CBA Committee initiated a joint project to revise the existing Statement to reflect further developments in the accounting and auditing standards, and the legal environment, and to provide enhanced guidance regarding the auditors’ and law firms’ communications responsibilities.

In early 2010, the project to revise the existing Statement was suspended as the International Accounting Standards Board (IASB) intended to revise International Accounting Standard (IAS) 37 *Provisions, Contingent Liabilities and Contingent Assets*. The AASB and the CBA Committee decided that it would be best to wait until this revised standard was issued before proceeding with the revisions to the Statement. In the interim, the AASB and the CBA developed and issued AuG-46 dealing with written communications with respect to claims and possible claims in circumstances outside the scope of the existing Statement, such as when the financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs). Subsequent to the development of AuG-46, the IASB decided not to amend IAS 37. As a result, in

mid-2013, the AASB and the CBA Committee decided to proceed with the project to revise the existing Statement.

Proposed changes

Fundamental proposed changes include:

- expanding the scope of the revised Statement to apply to in-house legal counsel who is acting in a legal capacity by performing a role that commonly would be performed by external legal counsel;
- providing a more detailed discussion on the legal concept of privilege;
- structuring the revised Statement to be accounting framework neutral so that it can be used regardless of the applicable financial reporting framework applied by management to evaluate the entity's claims and possible claims; and
- updating guidance with respect to the timing of issuance of the inquiry and response letters.

A more detailed overview of significant changes in the proposed revised Statement is provided in Appendix I.

Effective date

Subject to input the AASB and the CBA Committee receive from stakeholders, the revised Statement would be effective for inquiry letters dated on or after December 1, 2016. In the AASB's and CBA Committee's view, the proposed effective date would allow for sufficient time to implement the revised Statement.

Comments requested

The AASB and the CBA Committee request comments on any aspect of the proposed revised Statement. Comments are most helpful when they relate to a specific paragraph or group of paragraphs. Comments disagreeing with proposals in the revised Statement should clearly explain the problem and suggest alternative wording, supported by specific reasoning. It will also be helpful for the AASB and the CBA Committee to be made aware of agreement with proposals in the revised Statement.

The AASB and the CBA Committee welcome views on the following questions:

1. Do you agree that the purpose and scope set out in paragraphs 1-4 of the proposed revised Statement are appropriate and adequately described? In particular, do you agree that this revised Statement should apply to circumstances when communications regarding claims and possible claims involve the entity's in-house legal counsel who is acting in a legal capacity by performing a role that would commonly be performed by external legal counsel?

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2. Do you agree that the guidance in the proposed revised Statement addressing the roles, responsibilities and communication processes of management, the auditor and the law firm is appropriate?
 3. Do you agree that the guidance in the proposed revised Statement is capable of being clearly understood and consistently interpreted and applied?
 4. Do you agree with the proposed content of the examples in Schedules A through E? If not, what aspects are not useful, or what is missing? Specifically, what are your views about including in the revised Statement illustrations of management's evaluation of claims and possible claims in an inquiry letter, as set out in Schedule B?
 5. Do you agree that the proposed revised Statement is sufficiently comprehensive for the purpose of assisting auditors and law firms, together with financial statement preparers, to communicate effectively with respect to claims and possible claims as part of the auditor's examination of financial statements? If not, please specify what other material should be added to the revised Statement.

Questions 6 and 7 are relevant to those who apply Canadian Auditing Standards.

6. Do you agree with the proposed conforming amendments to paragraph CA25a of CAS 501 set out in Appendix II?
7. Are there any other conforming amendments required to CAS 501 as a result of revising the existing Statement? If so, please describe the nature and extent of the changes. Note that any amendments proposed would need to meet the criteria set out in Appendix II, under the heading "Criteria for amending ISAs when adopting them as CASs."

The deadline for responding to the AASB and the CBA Committee is **April 6, 2015**.

Written comments should be submitted by email (Word format preferred) as follows:

- For the AASB, please submit comments to: ed.assurancestds@cpacanada.ca
- For the CBA Committee, please submit comments to: epii@cba.org

Significant Changes in the Proposed Revised Statement

This Appendix provides an overview of the significant changes in the proposed revised “Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements” from the existing Statement, with the same title, and from AuG-46, Communications with Law Firms under New Accounting and Auditing Standards. This is not a complete list of changes. To fully understand changes being proposed, readers are encouraged to read the full text of each document.

Change in scope

The scope of the proposed revised Statement is expanded to include communications regarding claims and possible claims involving the entity’s in-house legal counsel who is acting in a legal capacity by performing a role that commonly would be performed by external legal counsel. The scope expansion assists in protecting privilege in communications with in-house legal counsel.

An enhanced introductory section

The proposed revised Statement includes a more detailed and comprehensive introduction. Its purpose is to raise awareness of the fundamental concepts underpinning the proposed revised Statement, such as the concept of privilege, and to clarify the respective responsibilities of the parties involved.

Structuring the Statement to be accounting framework neutral

The existing Statement and AuG-46 include terminology and relevant guidance pertaining to specific financial reporting frameworks. The proposed revised Statement has been developed without guidance relating to a specific financial reporting framework. The reason is that financial statements may be prepared using a variety of possible accounting standards and law firms should not be expected to be familiar with these standards in order to communicate under the Statement. As set out in paragraphs 37 and 38 of the proposed revised Statement, the law firm’s response will be based on its knowledge of the matter and professional insight. Familiarity with the accounting standards is not necessary.

To assist management in drafting the evaluation of claims and possible claims for inclusion in the inquiry letters, Schedule B in the proposed revised Statement illustrates ways to describe the evaluation of claims and possible claims under two of a number of possible financial reporting frameworks.

Communication protocols and timelines

Consistent with current guidance (found in paragraph 6 of the existing Statement), the inquiry letter will normally be delivered to the law firm at least three weeks before the effective date of response (unless impracticable).

Under current guidance (found in paragraph 16(a) of AuG-46), the effective date for the response letter will normally be not more than five business days before the anticipated auditor's report date. However, under paragraph 30 of the proposed revised Statement, specifying the effective date of response is a matter of the auditor's professional judgment. In some cases, the effective date might be set further away from the anticipated date of the auditor's report, depending on the auditor's assessment of the risk of material misstatement related to claims and possible claims and whether other audit procedures might provide sufficient appropriate audit evidence between the effective date of response and the date of the auditor's report.

Consistent with current guidance (found in paragraph 16(b) of AuG-46), the law firm will normally require five business days after the effective date of response to respond to the inquiry letter. However, paragraph 31 of the proposed revised Statement recognizes that there may be circumstances (for example, a securities offering), when the law firm is asked to respond earlier than five business days from the effective date of response. In such circumstances, the auditor will request management to notify the law firm of the shorter timeline and for both parties to determine a mutually agreeable response date.

If the law firm is unable to respond within five business days from the effective date of response, or such other date as is agreed, paragraph 45 of the proposed revised Statement provides that the response letter could be limited to claims that management and the auditor consider most significant.

Management's evaluation of the outcome of claims and possible claims

Paragraphs 11-12 of AuG-46 provide that, under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, management may evaluate a claim or a possible claim considering a number of factors and it may be appropriate to seek the law firm's confirmation of the reasonableness of management's conclusions relating to one or more of the factors, rather than to seek the law firm's confirmation on the evaluation itself.

Paragraphs 23-24 of the proposed revised Statement contemplate that management may decide to include in the inquiry letter its conclusions relating to factors used in its evaluation, but do not suggest that it is appropriate to seek the law firm's confirmation of the reasonableness of management's conclusions relating to the factors. The view is that, in the vast majority of circumstances, the law firm should be expected to confirm the reasonableness of management's evaluation of the claims and possible claims, rather than the reasonableness of one or more factors management used in making its evaluation.

An enhanced role of the auditor in ensuring that the inquiry letter has been adequately prepared

Paragraphs 32-34 of the proposed revised Statement introduce new guidance with respect to the auditor's role in ensuring that the inquiry letter is adequately prepared by management. It directs the auditor:

- to consider whether to request management to consult with the law firm in relation to claims and possible claims before management drafts the inquiry letter; and
- to review the inquiry letter prior to sending it to the law firm.

The form and content of the inquiry letter and the response letter

In the existing Statement, the elements to be included in the inquiry letter and the response letter are set out in illustrative letters only; there is no corresponding guidance in the body of the Statement that lists those elements. Paragraph 50 of the proposed revised Statement lists the elements to be included in the inquiry letter and Schedule A presents an illustrative inquiry letter. Paragraph 53 of the proposed revised Statement lists the elements to be included in the response letter and Schedule C presents an illustrative response letter. This guidance is intended to improve consistency in practice on the drafting of these letters.

Updated response letter

Paragraphs 56-58 of the proposed revised Statement introduce new guidance on updated response letters, including that management may authorize the auditor, in its initial inquiry letter to the law firm, to request the law firm for an updated response letter.

Schedule D provides an illustration of a request from an auditor for an updated response letter from the law firm. Schedule E provides an illustration of a response from the law firm to the auditor's request for an updated response letter.

Proposed Amendments to CAS 501 (relevant to those who apply Canadian Auditing Standards)

The AASB intends to append the proposed revised Joint Policy Statement (the “Statement”) to Canadian Auditing Standard (CAS) 501, *Audit Evidence — Specific Considerations for Selected Items*, in the CPA Handbook – Assurance, consistent with the existing Statement.

Proposed conforming amendments to CAS 501

The AASB is proposing to make conforming amendments to paragraph CA25a of CAS 501. Paragraph CA25a is a Canadian-only paragraph, included in application and other explanatory material when CAS 501 was adopted from International Standard on Auditing (ISA) 501, which refers Canadian users to the Statement. Amendments to ISAs are clearly identified in the CPA Canada Handbook – Assurance by adding an explanation at the beginning of the standard and by adding the letter C at the start of the amended paragraph or footnote number.

Amendments proposed to paragraph CA25a of CAS 501 are as follows. [New text is denoted by underlining and deleted text is struck through.]

CA25a. In Canada, ~~for communications between auditors and the entity's external legal counsel,~~ the method of communication with the entity's external legal counsel in connection with claims and possible claims as part of the auditor's examination of financial statements, is guided by the "Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements." Whereas CAS 501 refers to auditors seeking communications with the entity's external legal counsel, this Joint Policy Statement also applies to written communications between auditors and the entity's in-house legal counsel who act in a legal capacity by performing a role that commonly would be performed by external legal counsel. The terms "litigation" and "claims", taken together in CAS 501, have the same meaning as "claims" and "possible claims" in this Joint Policy Statement. This Joint Policy Statement is appended to this CAS. [This is a Canadian-only paragraph. There is no equivalent paragraph in corresponding ISA 501.]

Reasons

The reasons for the amendments proposed to paragraph CA25a of CAS 501 are as follows:

- Communications with respect to the entity's claims and possible claims involve the entity's auditors, but it is between management and the entity's legal counsel. The AASB is proposing to delete wording in the first sentence of paragraph CA25a

because it may incorrectly imply that the auditor and the entity's legal counsel communicate directly, without the involvement of management.

- Paragraph 9(a) of CAS 501 requires the auditor to inquire of in-house legal counsel, where applicable, in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement. The AASB is proposing to include additional wording in paragraph CA25a to assist readers in understanding that the revised Statement also applies to written communications between auditors and the entity's in-house legal counsel who act in a legal capacity by performing a role that commonly would be performed by external legal counsel.
- The proposed revised Statement uses the terms "claims" and "possible claims" whereas CAS 501 uses the terms "litigation" and "claims". The AASB is proposing to include additional wording in paragraph CA25a to acknowledge these terminology differences.

Criteria for amending ISAs when adopting them as CASs

With respect to the adoption of ISAs, the AASB's overriding goal is to adopt ISAs into the CPA Handbook – Assurance without amendment. However, there may be circumstances where amendments are required. The following sets out the limited circumstances when the AASB makes amendments to ISAs:

1. The AASB limits additions to an ISA to those required to comply with Canadian legal and regulatory requirements.¹
2. The AASB limits deletions from, or other amendments to, an ISA to the following:
 - (a) the elimination of options (alternatives) provided for in the ISA;
 - (b) requirements or guidance, the application of which Canadian law or regulation¹ does not permit, or which require amendments to be consistent with law or regulation; and
 - (c) requirements or guidance, where the ISA recognizes that different practices may apply in different jurisdictions and Canada is such a jurisdiction.
3. The AASB may make amendments to an ISA with respect to requirements or guidance that do not fall within 1 or 2 above when it believes that there are circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.

¹ Canadian incorporating or other governing legislation often requires entities to prepare financial statements in accordance with Canadian GAAP. Accordingly, if Canadian GAAP necessitates a different audit response in Canada, these differences fall within the definition of a legal or regulatory requirement.

4. To the extent possible, amendments that are:

- (a) additions to an ISA will not be inconsistent with the current requirements or guidance in the ISA; and
- (b) deletions from, or other amendments to, an ISA will be replaced by an appropriate alternative that achieves the objective of the deleted requirement.

Proposed amendments to an ISA are highlighted in exposure drafts of proposed Canadian standards. The AASB indicates the reasoning for the amendments and respondents are invited to comment on them, including when the amendment will not result in convergence with the ISA in accordance with the International Auditing and Assurance Standards Board's guide for national standard setters. Amendments to ISAs are separately identified in the final Handbook material.

PROPOSED JOINT POLICY STATEMENT CONCERNING COMMUNICATIONS WITH LAW FIRMS REGARDING CLAIMS AND POSSIBLE CLAIMS IN CONNECTION WITH THE PREPARATION AND AUDIT OF FINANCIAL STATEMENTS

(Effective for inquiry letters dated on or after December 1, 2016)

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Introduction

Purpose and Scope

1. The purpose of this Statement is to assist auditors and law firms, together with financial statement preparers (management), to communicate effectively with respect to claims and possible claims as part of an audit of financial statements prepared in accordance with the applicable financial reporting framework. It is in the public interest for auditors to have access to sufficient appropriate information to fulfil their professional responsibility in conducting the audit of the entity's financial statements. However, it is also in the public interest that such access does not affect confidentiality and privilege, which are intended to remain fully protected in all relevant communications among management, the auditor and the law firm.
2. This Statement also applies to circumstances when communications regarding claims and possible claims involve the entity's in-house legal counsel who is acting in a legal capacity by performing a role that commonly would be performed by external legal counsel.
3. This Statement has been approved by the Canadian Bar Association and by the Auditing and Assurance Standards Board for use by auditors and law firms in Canada. This Statement does not address the responsibilities of auditors and law firms in other jurisdictions.
4. This Statement does not apply to:
 - (a) Legal opinions from a law firm retained by the auditor;
 - (b) Legal opinions from a law firm retained by management on a matter unrelated to claims and possible claims;
 - (c) Audit inquiries made of a lawyer, including in-house legal counsel, related to a matter where the lawyer has not been acting in a legal capacity; and
 - (d) Audit inquiries made of a law firm in respect of such items as trust funds, unpaid accounts, unbilled charges, and contractual obligations and commitments of the entity.

Despite the exclusion of the above items from this Statement, the protection of confidentiality and privilege may still need to be considered in these instances.

Effective Date

5. The Statement applies to inquiry letters dated on or after December 1, 2016.

Definitions

6. For the purposes of this Statement, the following terms have the meanings attributed below:

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- (a) Applicable financial reporting framework – The financial reporting framework applied by management in the preparation of the financial statements.

Examples of financial reporting frameworks that are commonly encountered in Canada include:

- Those in the CPA Canada Handbook – Accounting:
 - International Financial Reporting Standards;
 - accounting standards for private enterprises;
 - accounting standards for not-for-profit organizations; and
 - accounting standards for pension plans; and
 - Public sector accounting standards in the CPA Canada Public Sector Accounting Handbook.
- (b) Auditor – The person or persons conducting the audit, usually the engagement partner or other members of the engagement team or, as applicable, the auditing firm.
- (c) Claim – A matter involving the entity that is, or may become, litigious with respect to which:
- (i) The law firm is representing or advising the entity; and
 - (ii) A demand or indication of demand has been communicated to or by the entity, carrying with it the possibility of future loss or gain.
- Accordingly, claims include those against third parties as well as those by third parties.
- (d) Date of the auditor’s report – The date the auditor dates the report on the financial statements.
- (e) Effective date of response – The date as of which the response letter from the law firm covers claims and possible claims involving the entity.
- (f) Entity – The organization whose financial statements are being audited.
- (g) In-house legal counsel – A lawyer or lawyers employed by the entity or by another entity within the same group of related entities.
- (h) Law firm – A sole practitioner, two or more lawyers practicing together in a partnership, corporation or other entity, or in-house legal counsel who acts in a legal capacity by performing a role that commonly would be performed by external legal counsel.

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- (i) Management – The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).
 - (j) Possible claim – A matter involving the entity that is, or may become, litigious with respect to which the law firm is representing or advising the entity, but a demand or indication of a demand has not been communicated to or by the entity.
 - (k) Records – The method or system used by the law firm to record services provided to the entity that may, but not necessarily, include time-charge records or docket entries.
 - (l) Response date – The date by which the law firm is requested to provide its response letter.

Fundamental Concepts

Confidentiality and Privilege

- 7. The process set out in this Statement is intended to ensure that confidentiality and privilege are protected in relevant communications among management, the auditor and the law firm. Every lawyer has a duty to hold in strict confidence all information acquired in the course of the professional relationship concerning the entity's affairs and may not divulge any such information unless expressly or impliedly authorized by the entity or required by law or regulation to do so. The entity has the right to deny third parties access to privileged communications between management and the law firm. Both management's inquiry letter and the response from the law firm are intended to be privileged and confidential communications provided to the auditor in connection with the preparation and audit of the financial statements
- 8. There are two types of privilege:
 - (a) Litigation privilege protects communications among management, the law firm and a third party, if any, for the dominant purpose of litigation, as well as information that has been produced or obtained for such purpose.
 - (b) Solicitor-client privilege protects communications between the law firm and the client related to the provision of legal advice and assistance. Solicitor-client privilege is considered by the courts to be a right of fundamental importance. However, facts communicated to a law firm do not become privileged because of that communication. Similarly, existing documents do not become privileged because those documents are forwarded to the lawyer. It is the communication that is privileged rather than the underlying

facts or documents. For example, customer complaints or a demand letter received from a supplier do not become privileged because those documents are sent by the entity to a law firm in order to seek legal advice. Similarly, the fact that payments have been made to satisfy prior claims does not become privileged because that fact is communicated to the law firm.

9. Solicitor-client privilege can apply whether the communication is with in-house legal counsel or external counsel. It is equally important that solicitor-client privilege be protected in respect of management communications with in-house legal counsel as with external counsel.
10. When communicating with the auditor, in-house legal counsel may provide management's evaluation of claims and possible claims to the auditor. In doing so, in-house legal counsel should not disclose legal opinions relating to claims and possible claims (regardless of whether those opinions are of external legal counsel or its own), or other privileged communications about claims and possible claims, unless directed to do so by the entity's management.
11. Privilege can be lost by disclosure of privileged information to a third party under the legal principle of waiver. A central intent of this Statement is to avoid loss of privilege by waiver. Disclosures pursuant to this Statement are not intended to waive privilege.
12. Management's inquiry letter and the response from the law firm are intended to remain privileged and this privilege must be asserted by the auditor on behalf of the entity any time a third party seeks disclosure of such letters.
13. The auditor's professional responsibility not to divulge information to a third party concerning the entity's affairs without consent, except as required by law or regulation of the relevant jurisdiction, applies to management's inquiry letter and the response from the law firm. Consequently:
 - (a) Management's inquiry letter must not be quoted from or specifically referred to by the auditor in the auditor's report, or be provided in whole or in part to any third party, without prior written consent of the entity's management;
 - (b) The law firm's response letter must not be quoted from or specifically referred to by the auditor in the auditor's report, or be provided in whole or in part to any third party, without prior written consent of the entity's management and the law firm; and
 - (c) The law firm's response letter must not be quoted from or referred to by management in the financial statements, without prior written consent of the law firm.

Sufficient Appropriate Audit Evidence

14. The auditor is required to obtain sufficient appropriate audit evidence regarding the completeness and accuracy of claims and possible claims involving the entity. Sufficiency is the measure of the quantity of audit evidence and appropriateness is the measure of the quality of audit evidence. The response letter from the law firm assists the auditor in obtaining sufficient appropriate audit evidence as to whether material claims and possible claims are known and whether management's evaluation is reasonable. In some cases, if information is withheld by the entity from the auditor because the entity is exercising its right of privilege, the auditor would not be able to obtain sufficient appropriate audit evidence to support the auditor's opinion without reservation on the entity's financial statements.

Financial Reporting Frameworks

15. Financial reporting frameworks may prescribe requirements as to:
- (a) When a claim or a possible claim should be recorded in the financial statements;
 - (b) The determination of the amount arising from a claim or a possible claim that should be recorded in the financial statements;
 - (c) When disclosures about a claim or a possible claim should be included in the notes to the financial statements; and
 - (d) The nature and extent of such required disclosures.
16. Financial statements may be prepared using one of several possible financial reporting frameworks depending on the type of entity and other factors. The financial reporting framework applied by management in the preparation of the financial statements will dictate the recognition, measurement, presentation and disclosure of claims and possible claims and provide the auditor with the criteria to audit management's evaluation.

Respective Responsibilities

17. Management of the entity is responsible for:
- (a) Identifying claims and possible claims that occur up to the date of approval of the financial statements;
 - (b) Evaluating their outcome in accordance with the applicable financial reporting framework; and
 - (c) Preparing an inquiry letter that includes an accurate description and evaluation of the claims and possible claims.

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18. If the auditor assesses a risk of material misstatement regarding identified claims or possible claims, or when audit procedures indicate that other material claims or possible claims may exist, the auditor is responsible for ensuring that management has adequately prepared the inquiry letter and that the inquiry letter is sent to the law firm. The method of communication with the law firm in connection with claims and possible claims as part of the auditor's examination of financial statements is guided by this Statement.
 19. The law firm is responsible for providing management with a written response to management's inquiry letter, with a copy to the auditor, in accordance with this Statement. The law firm is not expected to respond to an inquiry letter that is not prepared in accordance with this Statement.

Planning

20. The auditor will request management to coordinate with the law firm the expected timing of the inquiry letter and its response based on anticipated key dates (for example, the date of approval of the financial statements, and preliminary or final prospectus date in the case of securities offerings). Such coordination helps management, the auditor and the law firm to ensure that the inquiry letter is sent to the law firm and the related response is sent to management, with a copy to the auditor, in timeframes that are appropriate in the circumstances.

Responsibilities in Developing the Inquiry Letter

Management's Responsibilities

Evaluating the Outcome of Claims and Possible Claims

21. The description in the inquiry letter of management's evaluation of claims and possible claims will depend, in part, on the financial reporting framework being applied, as described in paragraphs 15 and 16.
22. There are uncertainties inherent in estimating the amount and timing of the outcome of claims and possible claims. Therefore, management's estimated amount of ultimate loss (or gain) is a matter of management's judgment based on assumptions, rather than a matter capable of precise measurement. Management may support its assumptions with different types of information drawn from internal and external sources, the relevance and reliability of which will vary. In many cases, the assumptions may be subjective.
23. Financial reporting frameworks may require management to perform an evaluation that takes different factors into account in assessing the outcome of claims or possible claims. The following are examples of factors that management may consider in making its evaluation:

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- Previous experience of management and others with similar claims or possible claims;
 - How management intends to respond to claims or possible claims (for example, whether it intends to contest the matter vigorously or to seek an out-of-court settlement);
 - The possible different outcomes of claims or possible claims and the risks and uncertainties associated with each of them; and
 - The likelihood and timing of the possible cash flows associated with each possible outcome.
24. In some instances, management may decide to include in the inquiry letter management's conclusions relating to the factors management used in making its evaluation. For example, this might be the case when factors that management has considered in making its evaluation are not likely to be known to the law firm. If management is uncertain which factors are appropriate to include in the inquiry letter, the auditor will encourage the entity's management to discuss the matter with the law firm, as indicated in paragraph 32. Consultation between management and the law firm is an important part of the process to ensure that the law firm can provide the requested confirmation.
25. The amounts that are recorded and the information that is disclosed in the entity's financial statements are not attributable to the law firm but reflect the decisions reached by management by reference to the applicable financial reporting framework, taking into account all relevant information and advice.

Auditor's Responsibilities

Suggesting Matters that May be Excluded from the Inquiry Letter

26. In some cases, following discussion with management, the auditor may be of the view that the inquiry letter need not list:
- (a) Matters of an identified type (for example, routine collections); and
 - (b) Matters involving amounts that aggregate to less than a stated amount.

In such cases, the auditor will request management to describe in the inquiry letter the nature of matters that may be excluded from the law firm's response. The auditor should recognize that a claim or a possible claim, immaterial in itself, may provide an indication of the probability of further similar claims or possible claims (for example, claims by a customer in respect of a defect in a major product line of the entity).

Specifying an Effective Date of Response and Response Date

27. The auditor will request management to complete its drafting of the inquiry letter and deliver it to the auditor so the auditor can send it to the law firm at least

three weeks in advance of the effective date of response, except when this is not practicable in the circumstances.

28. The auditor will request management to specify in the inquiry letter the following dates:
- (a) The effective date of response, which will be prior to the response date and no later than the anticipated date of the auditor's report; and
 - (b) The response date.
29. In specifying the effective date of response and response date, the auditor will take into account that the law firm will normally require five business days after the effective date of response to prepare the response letter.
30. Specifying the effective date of response is a matter of the auditor's professional judgment and may be affected by factors such as the following:
- (a) The auditor's assessment of the risk of material misstatement related to claims and possible claims in the particular engagement circumstances, including the existence of unidentified claims or possible claims; and
 - (b) The extent to which other audit procedures performed for the period between the effective date of response and the date of the auditor's report would provide the auditor with sufficient appropriate audit evidence regarding ongoing developments relating to claims and possible claims during that period.

For example, certain types of claims and possible claims that are in the normal course of the entity's business may not be expected to involve a high risk of material misstatement and, consequently, the effective date of response might be set further away from the anticipated date of the auditor's report. Audit evidence for the period between the effective date of response and the anticipated date of the auditor's report might be appropriately obtained by performing other procedures.

31. There may be circumstances, such as when the auditor is seeking an appropriate basis to consent to the use of a report of the auditor that will be included in a securities offering document, when the auditor may need to set the response date less than five business days from the effective date of response. In such circumstances, the auditor will request management to notify the law firm of the shorter timeline and determine with the law firm a mutually-agreeable response date.

Requesting Management to Consult with the Law Firm Prior to Sending the Inquiry Letter

32. To help ensure that the law firm is able to provide the requested confirmation with respect to claims and possible claims involving the entity, the auditor will

consider whether to request management to consult with the law firm before management drafts the inquiry letter. Such consultation may be particularly important when:

- (a) Management is uncertain regarding what is appropriate to include in the inquiry letter; and
- (b) Management requires assistance in making the evaluation of claims or possible claims.

Reviewing the Inquiry Letter Prior to Sending It to the Law Firm

- 33. The auditor will review the inquiry letter prior to sending it to the law firm and consider whether management has prepared it in a manner that should enable the law firm to provide a response that will be useful to the auditor. In doing so, the auditor will consider:
 - (a) Whether management has provided an evaluation of the outcome of claims and possible claims in a manner appropriate to the applicable financial reporting framework; and
 - (b) Whether the form and content of the inquiry letter complies with this Statement.
- 34. If the auditor believes that the inquiry letter has not been adequately prepared by management, the auditor will request management to revise the letter. An auditor's involvement in monitoring the quality of the inquiry letter does not reduce management's responsibility for evaluating the entity's claims and possible claims.

Sending the Inquiry Letter to the Law Firm

- 35. The auditor will request management to provide the inquiry letter to the auditor to send directly to the law firm, with a copy to management.

Responsibilities in Developing the Response Letter

Law Firm's Responsibilities

Confirming the Reasonableness of Management's Evaluation

- 36. The law firm will examine its records to identify claims and possible claims against and by the entity as of the effective date of response.
- 37. The law firm will determine whether it can confirm the reasonableness of management's evaluation based on its own knowledge of the matter. While there may be instances where the law firm will be unable to confirm the reasonableness of management's evaluation, it is in the entity's interest that the law firm makes a reasonable effort to do so.

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38. When a law firm confirms the reasonableness of management's evaluation, the law firm is not expressing a conclusion as to the ultimate outcome of claims and possible claims, or as to whether management has provided its evaluation in a manner appropriate to the applicable financial reporting framework. Rather, the law firm is providing the benefit of its professional insight based on its experience in litigation and settlement of claims and possible claims applied in the context of the facts and circumstances of the identified claims or possible claims. Such confirmation may be helpful to the entity in arriving at a decision on the appropriate financial statement treatment and to the auditor's consideration of that decision.

Disagreement with, or Lack of Clarity in, Management's Evaluation

39. If the law firm disagrees with, or is unclear about, management's evaluation, the law firm will discuss the matter with the entity's management as soon as practicable due to the possible effects on the financial statements or the auditor's report. Where appropriate, the law firm will suggest that management involve the auditor in those discussions.

Claims Omitted from the Inquiry Letter

40. If the law firm identifies outstanding claims that have been omitted from the inquiry letter, the law firm will specify such claims in the response letter.

Possible Claims Omitted From the Inquiry Letter

41. It is in the public interest that confidentiality and privilege of lawyer-client communications be maintained. Accordingly, the law firm will not specify in the response letter any possible claims that are omitted from the inquiry letter.
42. It is also in the public interest that the financial statements contain all adjustments and disclosures required in accordance with the applicable financial reporting framework. If the law firm identifies possible claims that have been omitted from the inquiry letter, the law firm will discuss such possible claims with management to ensure that management is aware of its responsibility to inform the auditor of possible claims omitted from the inquiry letter, and to make any appropriate adjustment of, or disclosure in, the financial statements.

Availability of the Response Letter by the Response Date

43. The law firm will make reasonable efforts to ensure that the response letter is received by management and the auditor no later than five business days from the effective date of response, or such other date as is agreed. If the law firm is unable to respond within five business days from the effective date of response, or such other date as is agreed, the law firm will advise the auditor and management of the date when its response will be available.

Reviewing the Wording of a Note to the Entity's Financial Statements

44. When requested to do so, the law firm will review, from a legal perspective, the proposed wording of any note to the entity's financial statements regarding claims and possible claims on which the law firm has been consulted.

Auditor's Responsibilities

Response Letter Will Not be Available by the Response Date

45. If the auditor is advised by the law firm that the response letter will be available at a date later than specified in the inquiry letter pursuant to paragraph 43, the auditor will discuss with management whether this delay will affect the proposed date of the auditor's report. If the effect is considered problematic, the auditor will request management and the law firm to discuss the matter to determine a mutually agreeable solution. For example, the response letter could be limited to particular claims that management and the auditor consider most significant, in light of the auditor's assessment of the risks of material misstatement. If a mutually agreeable solution cannot be reached, the auditor may not have sufficient time to consider and address any issues that may arise from the response, which may cause the auditor to defer the date of the auditor's report.

Inappropriately Prepared Response Letter

46. If the auditor concludes that the response letter has not been prepared in compliance with this Statement, the auditor will ask management to request the law firm to revise the letter. A discussion among management, the auditor and the law firm may be required to discuss the specifics of this request. An auditor's involvement in monitoring the quality of the response does not reduce the law firm's responsibility for providing a response letter that complies with this Statement.

Disagreement With, or Lack of Clarity In, Management's Evaluation

47. If, following the discussion contemplated by paragraph 39 with respect to disagreement with, or lack of clarity in, management's evaluation:
- (a) Management and the law firm reach an agreement on a revised evaluation, the auditor will request management to prepare a supplementary or amended inquiry letter to enable the law firm to confirm the revised evaluation.
 - (b) Management and the law firm do not reach an agreement on a revised evaluation, the auditor may prepare a memorandum of the discussion and request management and the law firm to confirm its accuracy.

If the matter remains unresolved, the auditor may not be able to obtain sufficient appropriate audit evidence to support the auditor's opinion without reservation on the entity's financial statements.

Claims Omitted from the Inquiry Letter

48. If the law firm's response letter identifies outstanding claims that have been omitted from the inquiry letter, the auditor will:
- (a) Obtain management's evaluation of the claims; and
 - (b) If judged necessary, request management to send a supplementary inquiry letter to the law firm.

Possible Claims Omitted from the Inquiry Letter

49. If the auditor becomes aware of possible claims that have been omitted from the inquiry letter, the auditor may, after discussing the possible claims with management, request management to send a supplementary inquiry letter to the law firm.

The Form and Content of the Inquiry and Response Letters

Inquiry Letter

50. The auditor will request management to prepare an inquiry letter that includes the following elements:
- (a) An indication that the letter is "Privileged and Confidential";
 - (b) An addressee (that is, the responsible lawyer(s) within the law firm);
 - (c) Identification of the entity and any related entities that have retained the law firm and to which the inquiry relates;
 - (d) The date of, and the period covered by, the financial statements;
 - (e) A description of the identified claims and possible claims and management's evaluation of their outcome, including estimated financial effect when required under the applicable financial reporting framework;
 - (f) If applicable, a description of the nature of matters in respect of which, and specific quantitative thresholds below which, claims and possible claims have been excluded from the inquiry letter;
 - (g) A request that the law firm:
 - (i) Acknowledge receipt to management and the auditor of the inquiry letter (which may be, but not limited to, by telephone or electronic mail);
 - (ii) Consider developments up to the effective date of response;
 - (iii) Address a reply to management, confirming whether:
 - a. Claims and possible claims are properly described;
 - b. Management's evaluation is reasonable; and

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- c. All outstanding claims are included in the inquiry letter;
 - (iv) When there are outstanding claims omitted from the inquiry letter, indicate the names of the parties and the amount claimed, taking into account any exclusions specified in the inquiry letter;
 - (v) Discuss possible claims with management when those are omitted from the inquiry letter;
 - (vi) Send a reply, marked "Privileged and Confidential", to the entity and a signed copy directly to the auditor (include name and appropriate contact information of auditor); and
 - (vii) Respond as of a specific date;
 - (h) A statement that acknowledges that the law firm will normally require five business days after the effective date of response to prepare the letter; or, if the response date is within a period of less than five business days from the effective date of response, a statement that the response date requested is within a period of less than the typical five business days from the effective date of the response and a description of the circumstances that give rise to such request;
 - (i) A request to advise management as soon as possible if the law firm is unable to meet the response date;
 - (j) If applicable, a statement that the auditor has been authorized to request, on behalf of management, an updated response letter(s) with a new effective date of response;
 - (k) A statement that the inquiry letter is prepared in accordance with this Statement; and
 - (l) An authorized signatory on behalf of the entity and its related entities.
51. Schedule A provides an illustration of an inquiry letter.
52. Schedule B provides illustrations of management's evaluation of claims and possible claims for inclusion in the inquiry letter.

Response Letter

53. The law firm will prepare a response letter that includes the following elements:
- (a) An indication that the letter is "Privileged and Confidential";
 - (b) An addressee (that is, the member of management who signed the inquiry letter);
 - (c) Confirmation as to whether claims and possible claims referred to in the inquiry letter have been properly described and reasonably evaluated, and

whether it contains all claims that are outstanding, taking into account any exclusions specified in the inquiry letter;

- (d) If applicable, a list of claims identified by the law firm that are outstanding, but have been omitted from the inquiry letter, taking into account any exclusions specified in the inquiry letter;
- (e) A statement that indicates that the response letter should not be quoted from or referred to in the entity's financial statements or quoted from or specifically referred to in the auditor's report, or be provided in whole or in part to any third party, without the prior written consent of the law firm;
- (f) An indication that a signed copy has been sent directly to the auditor;
- (g) A statement that the response letter has been prepared in accordance with this Statement; and
- (h) An authorized signatory on behalf of the law firm.

54. Schedule C provides an illustration of a response letter.

Supplementary or Amended Inquiry Letter and Related Response Letter

55. The auditor may ask management to prepare a supplementary or an amended inquiry letter to send to the law firm, with a copy to the auditor, requesting a supplementary or an amended response with an existing or a new effective date of response. This may be the case when:

- (a) A new claim or possible claim that is considered material to the financial statements comes to the auditor's attention after the effective date of the initial response letter; or
- (b) Management has revised its evaluation of a particular claim or possible claim that was included in the initial inquiry letter.

Any supplementary or amended inquiry letters and related response letters will be prepared in accordance with this Statement.

Updated Response Letter

56. Subject to authorization by management communicated to the law firm, the auditor may ask the law firm on behalf of management for an updated response letter with a new effective date of response for the purpose of updating all or part of the initial response letter. This may be the case when management considers its evaluation of a particular claim or possible claim provided in its initial inquiry letter to be unchanged, but the auditor decides that an updated confirmation from the law firm is necessary.

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57. Schedule D provides an illustration of a request from an auditor for an updated response letter from the law firm.
 58. Schedule E provides an illustration of a response from the law firm to the auditor's request for an updated response letter, sent to the entity's management, with a copy to the auditor.

Example of an Inquiry Letter

The following example is provided for use by management in preparation of inquiry letters and by auditors in their review of such letters, prior to sending it to the law firm.

[Company's letterhead]
Privileged and Confidential

[Responsible lawyer(s) within the law firm] (Date)

We write this letter to you at the request of our auditors, pursuant to the Joint Policy Statement of [insert date of JPS] between the Canadian Bar Association and the Auditing and Assurance Standards Board.

In connection with the preparation and audit of the financial statements of ABC Company for the fiscal period ended [insert fiscal year end], we seek your confirmation with respect to our evaluation of claims and possible claims on which your firm has advised or represented for the following:

- ABC Company
- [If applicable, insert the related entities that the law firm is retained by and to which the inquiry relates]

Please provide us, and our auditors, with your acknowledgment of receipt of this inquiry letter.

[Inquiry to the Law Firm]

Based on an examination of your records, we seek your confirmation, as of [insert effective date of response], of the following:

- (a) The claims and possible claims listed are appropriately described;
- (b) Our evaluations are reasonable; and
- (c) All outstanding claims (other than those that meet the exclusion criteria set out below) are included in this inquiry letter.

If there are outstanding claims omitted from this inquiry letter (other than allowed exclusions as described below), we ask that you indicate in the response letter the names of the parties and the amount claimed.

If there are possible claims omitted from this inquiry letter (other than allowed exclusions as described below), we ask that you contact us to discuss such items and the application of the Joint Policy Statement to those possible claims.

Management's Evaluation of Claims and Possible Claims

Description	Evaluation
[Indicate the following: <ul style="list-style-type: none">• date of filing,• the name of entities,• the name of other party,• nature of claim or possible claim,• amount claimed, and• current status]	[Indicate management's evaluation of the outcome of the claims or possible claims, including the estimated financial effect. ¹]

[Matters Excluded from this Letter²]

This letter does not include: [If applicable, describe the nature of matters in respect of which, and specific quantitative thresholds below which, claims and possible claims have been excluded from the inquiry letter.]

Therefore, in responding to this letter, you need not consider such matters.

[Required Timing of Response]

We would appreciate a response on or before [insert response date].

We understand that you will normally require five business days after the effective date of response to prepare your letter [or] If the response date is within a period of less than five business days from the effective date of response, state: We request a response date within a period of less than the typical five business days from the effective date of response due to [describe circumstances].

If you are unable to meet the response date, please advise us as soon as possible.

[Replying to this Letter]

Please address your reply, marked "Privileged and Confidential", to ABC Company, and send a signed copy of your reply directly to our auditor, [Insert name and appropriate contact information of auditor].

¹ Management's evaluation will need to conform to the financial reporting framework that management applies in the preparation of the financial statements. The law firm is not expected to be familiar with the applicable financial reporting framework or the accounting for an evaluation of claims or possible claims in order to respond to this request. See Schedule B for illustrations of management's evaluation of claims or possible claims for inclusion in the inquiry letter.

² Delete this section, if inapplicable.

[Authorization to Communicate Directly with the Auditor]

[We have authorized the auditor to request, on behalf of management, updated response letter(s) with a new effective date of response.]

Yours truly,

[An authorized signatory on behalf of the entity and its related entities]

[Name and title of authorized signatory]

c.c. [Name of auditor(s)]

Illustrations of Management’s Evaluation of Claims and Possible Claims

The following illustrations are not authoritative and are intended only to be a guide that may be used to assist management in drafting the evaluation of claims and possible claims, including the estimated financial effect, for inclusion in the inquiry letters. These illustrations, presented in a simplified form, make references to International Financial Reporting Standards and accounting standards for private enterprises, two of a number of possible financial reporting frameworks. There are significant differences between those two financial reporting frameworks, as well as other frameworks. Accordingly, management’s evaluation of claims and possible claims, including the content and the level of detail contained in the inquiry letter, may vary significantly depending on the financial reporting framework used by management to prepare the entity’s financial statements. Reading these illustrations is not a substitute for management considering the relevant accounting standards in their entirety in establishing its evaluations of claims and possible claims.

Illustration 1: The entity’s financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs). Circumstances include the following:

- **Claim 1.A: It is determined by the entity’s management that a loss is more likely than not to occur and the amount of the loss can be reliably estimated.**
- **Claim 1.B: It is determined by the entity’s management that a loss is more likely than not to occur and the amount of the loss cannot be reliably estimated.**
- **Claim 1.C: It is determined by the entity’s management that a loss is not more likely than not to occur.**
- **Claim 1.D: It is determined by the entity’s management that the occurrence of a loss is remote.**

Claim 1.A

Description	Evaluation
In January 20X1, YYZ Company filed a lawsuit against ABC Company alleging that ABC Company infringed on its patent rights. YYZ Company is claiming	Management has determined that a loss is more likely than not to occur and the amount of the loss can be reliably estimated. ¹ Management

¹ IFRSs state that, except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.

compensation for damages in the amount of \$10 million.

The Supreme Court of British Columbia announced that the trial will commence in the fourth quarter of 20X1. Discussions with YYZ Company to settle out of court have been ongoing.

intends to seek an out-of-court settlement in order to reduce legal costs and the overhang of an active lawsuit. There is a possibility that the case will go to court, but based on similar lawsuits filed in the past against ABC Company, management has determined that an out-of-court settlement is the most likely outcome. Management estimates the range of possible loss to be from \$3 million to \$6 million. Similar lawsuits filed in the past against ABC Company resulted in settlement amounts within that range. Management's best estimate of the loss is \$5 million.

Claim 1.B

Description	Evaluation
<p>In January 20X1, a class action lawsuit was filed against ABC Company by 200 individuals who reside around the company's plant land. The individuals are alleging that contamination caused by waste from ABC Company's production process has generated unsafe emissions that caused damage to their health and impairment to the value of their property. The individuals are collectively seeking compensation for damages in the amount of \$10 million.</p> <p>In December 20X1, the superior court of appeals decided in favour of letting this class action lawsuit proceed.</p>	<p>Management has determined that a loss is more likely than not to occur because excavations show soil contamination of the area around the plant land. Management has determined that the loss amount cannot be reliably estimated² due to the stage of the proceedings and the lack of facts or other information about:</p> <ul style="list-style-type: none">• The source of the contamination, given that many entities operate in the same area of and produce similar waste; and• The extent of the damage to the health of the plaintiffs and the impairment to the value of their properties, if any.

² IFRSs state that it is only in extremely rare cases that an entity will not be able to determine a range of possible outcomes and, therefore, make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.

Management intends to seek out-of-court settlement. However, management believes that the matter will be subject to negotiation and litigation over many years before the parties reach an agreeable settlement amount.

Claim 1.C

Description

Since January 20X2, ABC Company has been defending its position in a lawsuit brought by XYZ Company, a former supplier, for damages due to lost profits from terminating the February 28, 20X1, contract early without justifiable cause. The lawsuit seeks punitive damages of \$1 million. ABC Company has filed its defence and counterclaim in the amount of \$1 million.

Evaluation

Management has determined that a loss is not more likely than not to occur. Management believes that the contract was terminated with justifiable cause on the grounds that the supplier failed to deliver the agreed upon services under the terms of the contract. Management intends to defend the matter vigorously. A court ruling is expected in about two years.

Claim 1.D

Description

In January 20X1, a lawsuit was filed by a former employee of ABC Company claiming wrongful employment termination. The lawsuit seeks damages in the amount of \$1 million. A trial date has not yet been set.

Evaluation

Management has determined that the occurrence of a loss is remote. Management believes that the claim is without merit and intends to defend the matter vigorously.

Illustration 2: The entity's financial statements are prepared in accordance with accounting standards for private enterprises.

Circumstances include the following:

- **Claim 2.A: It is determined by the entity's management that a loss is likely to occur and the amount can be reasonably estimated.**
- **Claim 2.B: It is determined by the entity's management that a loss is likely to occur and the amount cannot be reasonably estimated.**
- **Claim 2.C: It is determined by the entity's management that the likelihood of a loss is not determinable.**

Claim 2.A

Description	Evaluation
<p>In January 20X1, YYZ Company filed a lawsuit against ABC Company alleging that the ABC Company infringed on its patent rights. YYZ Company is claiming compensation for damages in the amount of \$10 million.</p> <p>The Supreme Court of British Columbia announced that the trial will commence in the fourth quarter of 20X1. Discussions with YYZ Company to settle out of court have been ongoing.</p>	<p>Management has determined that a loss is likely to occur and the amount of the loss can be reasonably estimated. The entity intends to seek an out-of-court settlement in order to reduce legal costs and the overhang of an active lawsuit. Discussions to resolve this claim have advanced to a point where \$6 million is the estimated loss.</p>

Claim 2.B

Description	Evaluation
<p>In January 20X1, a class action lawsuit was filed against ABC Company by 200 individuals who reside around the company's plant land. The individuals are alleging that contamination caused by waste from ABC Company's production process has generated unsafe emissions that caused damage to their health and impairment to the value of their property. The individuals are collectively seeking compensation for damages in the amount of \$10 million.</p>	<p>Management has determined that a loss is likely to occur because excavations show soil contamination of the area around the plant land. Management has determined that the loss amount cannot be reasonably estimated due to the stage of proceedings and the lack of facts or other information about:</p> <ul style="list-style-type: none">• The source of the contamination, given that many entities operate

In December 20X1, the Superior Court decided in favour of letting this class action lawsuit proceed.

in the same area and produce similar waste; and

- The extent of the damage to the health of the plaintiffs and the impairment to the value of their properties, if any.

Management intends to seek an out-of-court settlement. However, management believes that the matter will be subject to negotiation and litigation over many years before the parties reach an agreeable settlement amount.

Claim 2.C

Description

In January 20X1, a lawsuit was filed against ABC Company in the Supreme Court of Ontario by XYZ Technology Inc. seeking compensation of \$5 million for alleged breach of a software license contract. The contract had been terminated by ABC Company due to technical defects in the software. ABC Company filed its defence in June 20X2. A trial date is expected in the fourth quarter of 20X2.

Evaluation

Management has determined that the likelihood of a loss is not determinable as this proceeding is at a very early stage. ABC Company believes it has adequate defences to this claim, but it is not possible at this time for management to determine the outcome of this action, the amount of the loss, if any, or the timing of resolution of the matter.

Example of a Response Letter

The following example is provided for use by law firms in preparation of response letters.

[Law Firm's letterhead]
Privileged and Confidential

[Appropriate Addressee] (Date)

We are replying to your letter of [insert date of letter], in accordance with the Joint Policy Statement referred to in that letter.

Based on an examination of our records, we confirm that, as of [insert the effective date of response], the claims and possible claims referred to in your letter with regards to which our advice and representation has been sought:

(a) have been properly described [except for the following:

Parties	Amount Claimed]
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(b) have been reasonably evaluated [except for the following with respect to which we cannot confirm:

Parties	Amount Claimed]
---------	-----------------

(c) include all claims that are outstanding, taking into account the exclusions specified in the inquiry letter [except for the following:

Parties	Amount Claimed]
---------	-----------------

This letter must not be quoted from or referred to in your financial statements or quoted from or specifically referred to in the auditor's report, or be provided in whole or in part to any third party, without our prior written consent.

Yours truly,

[Authorized signatory on behalf of the law firm]

[Name and title of authorized signatory]

c.c. [Signed copy to auditor]

Example of a Request for an Updated Response Letter

The following example is provided for use by auditors in preparation of a request for an updated response letter from a law firm.

[Auditor's letterhead]
Privileged and Confidential

[Responsible lawyer(s) within the law firm] (Date)

On behalf of management of ABC Company (and related entities), and in connection with the preparation and audit of the financial statements of ABC Company for the fiscal period ended [insert fiscal year-end], we seek an update of your response dated [insert date of initial response letter] to the letter from ABC Company with respect to the following particular claims and possible claims on which your firm has advised or represented:

Parties	Amount Claimed
---------	----------------

Based on an examination of your records, please confirm that as of [insert the new effective date of response] your response with respect to management's evaluation of the above claims and possible claims remains unchanged from your earlier response in your letter dated [insert date of initial response letter].

We would appreciate a response on or before [insert updated response date]. If you are unable to meet the response date, please advise us as soon as possible.

Please address the reply, marked "Privileged and Confidential", to ABC Company, and send a signed copy of your reply directly to us, [insert name and appropriate contact information of auditors].

Yours truly,

[Authorized signatory on behalf of the auditor]

[Name and title of authorized signatory]

Example of an Updated Response Letter

The following example is provided for use by law firms in responding to the auditor's request for an updated response letter, sent to the entity's management, with a copy to the auditor.

[Law Firm's letterhead]
Privileged and Confidential

[Appropriate addressee] (Date)

We are replying to your auditor's request for an update to our response letter dated [insert date of initial response letter] with respect to the claims and possible claims referred to in the inquiry letter dated [insert date].

Based on an examination of our records, we confirm that as of [insert the new effective date of response] our response remains unchanged from our earlier response in our letter dated [insert date of initial response letter].

[or]

Based on an examination of our records, we confirm that as of [insert the new effective date of response] our earlier response in our letter dated [insert date of initial response letter] has changed with respect to the following particular claims and possible claims [insert claims and possible claims] as a result of [insert a reason, for example, a change in the description of a claim or a possible claims from your earlier inquiry letter/a change in evaluation of a claim or possible claims from your earlier inquiry letter/the existence of a new claim not described in your earlier inquiry letter].

This letter must not be quoted from or referred to in your financial statements or quoted from or specifically referred to in the auditor's report, or be provided in whole or in part to any third party, without our prior written consent.

Yours truly,

[Authorized signatory on behalf of the law firm]

[Name and title of authorized signatory]

c.c. [Signed copy to auditor]

CONFORMING AMENDMENT (Relevant to those who apply Canadian Auditing Standards)

The following significant conforming amendment has been identified. Additional text is denoted by underlining and deleted text by strikethrough.

Canadian Auditing Standard (CAS) 501, *Audit Evidence — Specific Considerations for Selected Items*, in the CPA Handbook – Assurance

CA25a. In Canada, ~~for communications between auditors and the entity's external legal counsel,~~ the method of communication with the entity's ~~external~~ legal counsel in connection with claims and possible claims as part of the auditor's examination of financial statements, is guided by the "Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements." Whereas CAS 501 refers to auditors seeking communications with the entity's external legal counsel, this Joint Policy Statement also applies to written communications between auditors and the entity's in-house legal counsel who act in a legal capacity by performing a role that commonly would be performed by external legal counsel. The terms "litigation" and "claims", taken together in CAS 501, have the same meaning as "claims" and "possible claims" in this Joint Policy Statement. This Joint Policy Statement is appended to this CAS. [This is a Canadian-only paragraph. There is no equivalent paragraph in corresponding ISA 501.]

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