

# Audit & Assurance Alert

CAS

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## Significant Revisions to the Joint Policy Statement

This Audit & Assurance Alert is being issued to alert audit practitioners to the significant changes in the revised “Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements” (herein JPS), which is an appendix in Canadian Auditing Standard (CAS) 501, *Audit Evidence – Specific Considerations for Selected Items*. The purpose of the JPS is to assist auditors and law firms,<sup>1</sup> 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, if the auditor has decided that such communication is required.

The revised JPS will replace the following in the *CPA Canada Handbook—Assurance*:

- the existing JPS with the same title, which was appended to CAS 501
- Assurance and Related Services Guideline, AuG-46, *Communication with Law Firms under New Accounting and Auditing Standards*

This Alert does not address all changes in the JPS. To fully understand changes to the existing JPS, readers are encouraged to read the full text of each document.

<sup>1</sup> Paragraph 6(h) of the JPS defines a law firm as “a sole practitioner, two or more lawyers practicing together in a partnership, corporation or other entity, or in-house legal counsel who is representing or advising the entity with respect to claims and possible claims.”

## When is the JPS effective?

The revised JPS is effective for inquiry letters dated on or after December 1, 2016.

## What has changed?

### In-House Legal Counsel

The existing JPS covers communications involving the entity's external legal counsel only.

The scope of the revised JPS has been expanded to include communications regarding claims and possible claims involving the entity's in-house legal counsel representing or advising the entity with respect to claims. The scope of the JPS was expanded to assist in protecting privilege in communications with in-house legal counsel. The auditor may communicate with in-house legal house when the entity uses in-house legal counsel, in addition to or in place of external legal counsel, to represent or advise it with respect to litigation or claims. In these circumstances, such communication is guided by the JPS.

### Financial Reporting Framework

The revised JPS has been developed to be accounting-framework neutral so that it can be applied regardless of the financial reporting framework used by management to evaluate the entity's claims and possible claims. The reason for such neutrality is that financial statements may be prepared using a variety of possible accounting standards. Law firms are not expected to be familiar with these standards in order to communicate under the JPS. The law firm's response will be based on its knowledge of the matter and professional insight.

To assist management in drafting the evaluation of claims and possible claims for inclusion in the inquiry letters, a schedule has been included in the revised JPS (Schedule B). This schedule provides an illustration to assist management in describing the evaluation of claims and possible claims under two of a number of possible financial reporting frameworks.

### Communication Protocols and Timelines

The existing JPS included three important dates (i.e., the delivery date, the effective date of response and the response date). The revised JPS also includes these dates, but provides more clarity and reflects good practices regarding the auditors' and law firm's communications responsibilities, particularly related to the timelines for the law firm to respond to inquiries.

#### *Delivery date*

This is the date the auditor sends the inquiry letter (prepared by management) to the law firm. Consistent with the existing JPS, the inquiry letter will normally be delivered to the law firm at least three weeks before the effective date of response.

### **Effective date of response**

This is the date as of which the response letter from the law firm covers claims and possible claims involving the entity. Under the existing guidance, the effective date for the response letter would normally have been not more than five business days before the anticipated auditor's report date. However, the revised JPS introduces greater flexibility in setting the effective date of response specified in the inquiry letter, depending on the auditor's professional judgment. The auditor's professional judgment may be affected by:

- the auditor's assessment of the risk of material misstatement related to claims and possible claims
- whether other audit procedures might provide sufficient appropriate audit evidence between the effective date of response and the date of the auditor's report.

### **Response date**

This is the date by which the law firm is requested to provide its response letter to the auditor and management. Consistent with existing guidance, the law firm will normally require five business days after the effective date of response to respond to the inquiry letter. However, the revised JPS recognizes that there may be circumstances (e.g., a securities offering), under which the law firm is asked to respond earlier than five business days from the effective date of response. In such circumstances, the auditor will consult the law firm and management as soon as practicable to determine a mutually- agreeable response date. Additionally, the revised JPS includes communication protocols addressing the circumstances where the law firm is unable to respond within five business days of the effective date of response.

### **Inquiry Letter**

The purpose of an inquiry letter is for management to provide an evaluation of the outcome of claims and possible claims in a manner appropriate to the applicable financial reporting framework, so the law firm can confirm the reasonableness of management's evaluations.

### **Content of the inquiry letter**

In the existing JPS, the elements to be included in the inquiry letter are set out in illustrative letters only. The revised JPS introduces guidance and illustrations intended to improve consistency in practice on the drafting of the inquiry letter. Paragraph 50 of the revised JPS lists the elements to be included in the inquiry letter; and Schedules A and B present illustrative<sup>2</sup> inquiry letters.

Here are some of the elements of the inquiry letter:

- acknowledgement by the law firm to management and to the auditor of receipt of the inquiry letter
- explicit request by the law firm to discuss possible claims with management when these have been omitted from the inquiry letter
- acknowledgement by the law firm that they will normally require five business days after the effective date of response to prepare the letter or, where the requested response date is within a period of less than five business days from the effective

<sup>2</sup> The format and content of these illustrative letters are for guidance only. Professional judgment must be exercised when drafting the letters.

date of response, the letter will include 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

- a request by the law firm to advise management and the auditors as soon as practicable whether the law firm is unable to meet the response date
- authorization by the auditors to request, if they deem necessary, an updated response letter(s) with a new effective date of response from the law firm.

### **Enhanced role of the auditor**

Paragraphs 33-35 of the revised JPS introduce new guidance with respect to the auditor's role in ensuring management adequately prepares the inquiry letter. It directs the auditor to:

- consider whether to request management to consult with the law firm concerning claims and possible claims before management drafts the inquiry letter
- review the inquiry letter prior to sending it to the law firm and consider whether management has prepared it in a manner that will enable the law firm to provide a response useful to the auditor.

### **Response Letter**

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 the existing JPS, the elements to be included in the response letter from the law firm are set out in illustrative letters only. No additional guidance is provided in the body of the existing JPS. The revised JPS provides guidance in the body of the JPS. This guidance is intended to improve consistency in practice when drafting these letters. Also, Schedule C presents an illustrative response letter.

### **Updated Response Letter**

The revised JPS introduces guidance that encourages communication among management, the auditor and the law firm when determining a mutually agreeable response date for updated response letters. The revised JPS states that management may authorize the auditor, in its initial inquiry letter to the law firm, to request an updated response letter from the law firm. Also, it includes an illustration (Schedule D) of a request from the auditor for an updated response letter from the law firm. It also provides an illustration (Schedule E) of a response from the law firm to the auditor's request for an updated response letter.

### **Other Resources**

1. Canadian Auditing Standard (CAS) 501, *Audit Evidence—Specific Elements of Financial Statements, Appendix*
2. *Basis for Conclusions: [Joint Policy Statement Concerning Communications with Law Firms Regarding Claims and Possible Claims in Connection with the Preparation and Audit of Financial Statements](#)*

## Comments and Feedback

Comments on this *Audit & Assurance Alert* or suggestions for future *Alerts* should be sent to either:

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