

**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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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, if the auditor has determined that such communication is required. 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 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 where communications regarding claims and possible claims involve the entity's in-house legal counsel who is representing or advising the entity with respect to claims and possible claims.
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 representing or advising the entity with respect to claims and possible claims; 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:
 - (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 (including regulatory or administrative proceedings) with respect to which:
- (i) The law firm is representing or advising the entity; and
 - (ii) A demand or indication of a demand, carrying with it the possibility of future loss or gain, has been communicated to or by the entity.
- Claims include those against the entity as well as those by the entity.
- (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 is representing or advising the entity with respect to claims and possible claims.
- (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 (including regulatory or administrative proceedings) with respect to which:
- (i) The law firm is representing or advising the entity; and
 - (ii) A demand or indication of a demand, carrying with it the possibility of future loss or gain, has not been communicated to or by the entity.

Possible claims include those against the entity as well as those 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 all 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:
 - (a) expressly or impliedly authorized to do so by the entity; or
 - (b) required to do so by law or regulation.
8. The entity has the right to deny other persons 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 confidential and privileged communications provided to the auditor in connection with the preparation and audit of financial statements.
9. There are two types of privilege:
 - (a) Litigation privilege protects communications among management, a lawyer and other persons, if any, for the dominant purpose of litigation or anticipated litigation, as well as information that has been produced or obtained for such purpose.
 - (b) Solicitor-client privilege protects communications between a lawyer 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 lawyer do not become privileged because of that communication. Similarly, existing documents do not become privileged because those documents are forwarded to a 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 lawyer 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 a lawyer.

Privilege can apply whether the communication is with in-house legal counsel or with external legal counsel and it is equally important that privilege be protected in both situations.

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 other persons 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 disclosure of such letters is sought.
13. The auditor's professional responsibility not to divulge information 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 other person, without prior written consent of the entity's management; and
 - (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 other person, without prior written consent of the entity's management and the law firm.
14. The law firm's response letter must not be quoted from or referred to in the financial statements, without prior written consent of the law firm. The law firm may be requested by management to review the proposed wording of disclosures included in the notes to the financial statements regarding claims and possible claims on which the law firm has been consulted.

Sufficient Appropriate Audit Evidence

15. 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

16. 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.
17. 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 generally 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

18. 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.
19. 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.
20. 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

21. 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

22. 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 16 and 17.
23. 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.
24. 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:
 - 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.
25. 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 where 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 33. 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.
26. 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

Agreeing on Matters that May Be Excluded from the Inquiry Letter

27. In some cases, following discussion, the auditor and management may agree 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. However, 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 the Response Date

28. 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.

29. 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.

30. 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.

31. 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 anticipated 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.

32. 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, where the auditor may need to request a response date that is less 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.

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

33. 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

34. 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.
35. If the auditor believes that the inquiry letter has not been adequately prepared by management, the auditor will request management to revise the letter. The auditor's responsibility to review the inquiry letter does not reduce management's responsibility to evaluate the entity's claims and possible claims in accordance with the applicable financial reporting framework.

Sending the Inquiry Letter to the Law Firm

36. 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

37. 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.
38. 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.
39. 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 statements treatment and to the auditor's consideration of that decision.

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

40. If the law firm disagrees with the reasonableness of, or is unclear on, 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

41. 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, taking into account any exclusions described in the inquiry letter.

Possible Claims Omitted from the Inquiry Letter

42. 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.
43. 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 responsibilities to inform the auditor of possible claims omitted from the inquiry letter, and make any appropriate adjustments of, or disclosures in, the financial statements.

Availability of the Response Letter by the Response Date

44. 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 management and the auditor as soon as practicable of the date when its response will be available.

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 44, the auditor will discuss with management whether this delay will affect the anticipated 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 and possible 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 law firm and the auditor may be required to discuss the specifics of this request.

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

47. If, following the discussion contemplated by paragraph 40 with respect to the law firm's disagreement with the reasonableness of, 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, as described in paragraph 56, 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, or the auditor otherwise becomes aware of, 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, as described in paragraph 56, 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, as described in paragraph 56, 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 appropriately described;
 - b. Management's evaluation is reasonable; and
 - 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 described 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 auditors (include names and appropriate contact information of auditors); 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, where the requested response date is within a period of less than five business days from the effective 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;
 - (i) A request to advise management and the auditors as soon as practicable if the law firm is unable to meet the response date;
 - (j) If applicable, a statement that the auditors have been authorized to request, if they deem necessary, 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. The auditor may request management to prepare a letter of inquiry when management has determined that there are no claims or possible claims to be listed. Such a circumstance may arise where the risk assessment or other procedures performed by the auditor indicate that material claims or possible claims may exist.
52. Schedule A provides illustrations of inquiry letters.
53. Schedule B provides illustrations of management's evaluation of claims and possible claims for inclusion in the inquiry letter when there are claims or possible claims to be listed.

Response Letter

54. 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 appropriately described and reasonably evaluated, and whether it contains all claims that are outstanding, taking into account any exclusions described 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 described 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 other person, without the prior written consent of the law firm;
- (f) An indication that a signed copy has been sent directly to the auditors;
- (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.

55. Schedule C provides illustrations of response letters.

Supplementary or Amended Inquiry Letter and Related Response Letter

56. The auditor may request 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

57. Subject to authorization by management communicated to the law firm, the auditor may request 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 particular claims or possible claims provided in its initial inquiry letter to be unchanged, but the auditor decides that an updated confirmation from the law firm is necessary.
58. In specifying the effective date of response and the response date in a request for an updated response letter, 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 updated response letter. However, there may be circumstances, such as when the auditor is seeking an update on only part of the initial response letter, where the auditor may request a response date that is less than five business days from the effective date of response. In such circumstances, the auditor will consult with the law firm and management as soon as practicable to determine a mutually

agreeable response date. If the law firm is subsequently unable to respond by the mutually agreed response date, the law firm will advise management and the auditor as soon as practicable of the date when its response will be available.

59. Schedule D provides an illustration of a request for an updated response letter.
60. Schedule E provides an illustration of an updated response letter.

Examples of Inquiry Letters¹

Example 1:

The following example is provided for use by management in preparation of inquiry letters when there are claims or possible claims to be listed.

[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, effective December 1, 2016, between the Canadian Bar Association and the Auditing and Assurance Standards Board.

In connection with the preparation and audit of 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 represented or advised 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 evaluation is reasonable; and
- (c) All outstanding claims are included in this inquiry letter (other than any exclusions described below).

If there are outstanding claims omitted from this inquiry letter (other than any exclusions 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 any exclusions 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
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¹ Throughout these examples, the words in square brackets indicate where the example would be customized. The italicized headings in square brackets are meant to be explanatory for the preparers and would not be included in the letter.

[Indicate the following:

- date of filing,
- the names of entities,
- the names of other parties,
- nature of claim or possible claim,
- amount claimed, and
- current status]

[Indicate management's evaluation of the outcome of claims and possible claims, including the estimated financial effect.^{2]}

[Matters Excluded from this Letter^{3]}

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] *When 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 and our auditors as soon as practicable.

[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 auditors, [Insert name(s) and appropriate contact information of auditor(s)].

[Authorization to Communicate Directly with Our Auditors]

We have authorized our auditors to request, if they deem necessary, an 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]

² 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.

³ Delete this section, if inapplicable.

[Name and title of authorized signatory]

cc: [Name of auditor(s)]

Example 2:

The following example is provided for use by management in preparation of inquiry letters when there are no claims or possible claims to be listed.

[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, effective December 1, 2016, between the Canadian Bar Association and the Auditing and Assurance Standards Board.

In connection with the preparation and audit of financial statements of ABC Company for the fiscal period ended [insert fiscal year end], we seek your confirmation that there are no claims on which your firm has represented or advised 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 that there are no claims that are outstanding as of [insert effective date of response] (other than any exclusions described below).

If there are outstanding claims (other than any exclusions 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 (other than any exclusions described below), we ask that you contact us to discuss such items and the application of the Joint Policy Statement to those possible claims.

[Matters Excluded from this Letter⁴]

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] *When 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].

⁴ Delete this section, if inapplicable

If you are unable to meet the response date, please advise us and our auditors as soon as practicable.

[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 auditors, [Insert names and appropriate contact information of auditors].

[Authorization to Communicate Directly with Our Auditors]

We have authorized our auditors to request, if they deem necessary, an 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]

cc: [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 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 inquiry letters, 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 evaluation 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
<p>In January 20X1, YYZ Company filed a lawsuit against ABC Company alleging that 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</p>	<p>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 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</p>

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.

with YYZ Company to settle out of court have been ongoing.

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

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.

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

Evaluation

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:

- 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.

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

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.

amount.

Claim 1.C

Description

Since January 20X1, 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, 20X0, contract 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 a loss is not likely to occur.**
- **Claim 2.D: It is determined by the entity’s management that the likelihood of a loss is not determinable.**

Claim 2.A

Description

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.

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.

Evaluation

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.

Claim 2.B

Description

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.

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

Evaluation

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:

- The source of the contamination, given that many entities operate 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.D

Description

Since January 20X1, 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, 20X0, contract 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 likely 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 2.D

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.

Examples of Response Letters¹**Example 1:**

The following example is provided for use by law firms in preparation of response letters when responding to inquiry letters where there are claims or possible claims listed (such as the inquiry letter in Example 1 of Schedule A).

[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 or possible claims referred to in your letter with regard to which our representation or advice has been sought:

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

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

Names of the Parties	Amount Claimed]
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(c) include all claims that are outstanding, taking into account any exclusions described in the inquiry letter [except for the following:

Names of the Parties	Amount Claimed]
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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 other person, without our prior written consent.

Yours truly,

[Authorized signatory on behalf of the law firm]

[Name and title of authorized signatory]

cc: [Name of auditor(s)]

¹ Throughout these examples, the words in square brackets indicate where the example would be customized.

Example 2: The following example is provided for use by law firms in preparation of response letters when responding to inquiry letters where there are no claims listed (such as the inquiry letter in Example 2 of Schedule A).

[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], there are no claims that are outstanding [or] *When there are claims that are outstanding, state:* We have identified in our records the following claim(s) which is (are) outstanding as of [insert the effective date of response].

[Names of the 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 other person, without our prior written consent.

Yours truly,

[Authorized signatory on behalf of the law firm]

[Name and title of authorized signatory]

cc: [Name of auditor(s)]

Example of a Request for an Updated Response Letter¹

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 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 dated [insert date of initial inquiry letter].

Based on an examination of your records, we seek your confirmation that as of [insert the new effective date of response] your response with respect to management's inquiries [including its evaluation of the following claims and possible claims,] remains unchanged from your earlier response in your letter dated [insert date of initial response letter]:

[Names of the Parties	Amount Claimed]
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We would appreciate a response on or before [insert updated response date]. If you are unable to meet the response date, please advise us and management as soon as practicable.

Please address the reply, marked "Privileged and Confidential", to ABC Company, and send a signed copy of your reply to us.

Yours truly,

[Authorized signatory on behalf of the auditors]

[Name and title of authorized signatory]

cc: [Name of management within ABC Company]

¹ Throughout these examples, the words in square brackets indicate where the example would be customized.

Example of an Updated Response Letter¹

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 auditors.

[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] to 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]

Where change to the initial response letter has been identified, state: 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

[Names of the Parties Amount Claimed]

[Insert a reason, for example, a change in the description of a claim or a possible claim from your earlier inquiry letter/a change in evaluation of a claim or a possible claim 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 other person, without our prior written consent.

Yours truly,

[Authorized signatory on behalf of the law firm]

[Name and title of authorized signatory]

cc: [Signed copy to auditor]

¹ Throughout these examples, the words in square brackets indicate where the example would be customized.

CONFORMING AMENDMENTS TO CAS 501:

- CA25A.** In Canada, the method of communication with the entity's 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." 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.]
- CA25B.** In some cases, the entity may use 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 Canada, the auditor may seek written communication with such in-house legal counsel, when the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist. In these circumstances, written communication with the entity's in-house legal counsel is also 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". [This is a Canadian-only paragraph. There is no equivalent paragraph in corresponding ISA 501.]
- CA25C.** When communication from legal counsel is to be used as audit evidence, the auditor considers the relevance and reliability of the information upon which it is based. CAS 500 establishes requirements and provides guidance in this regard¹. [This is a Canadian-only paragraph. There is no equivalent paragraph in corresponding ISA 501.]

¹ CAS 500, paragraphs 7-9