FAQs for Lawyers on JPS on Audit Inquiries

We have prepared these brief questions and answers to help clarify for the legal profession the most significant features of the updated Joint Policy Statement on Audit Inquiries and their practical impact. Please always refer to the Joint Policy Statement itself when determining your responsibilities in the context of an audit inquiry.

Q. 1	**What is the JPS?**
A.	The Joint Policy Statement on Audit Inquiries is an agreement between the CBA and the Auditing and Assurance Standards Board (AASB) establishing a process for the making of inquiries by clients, at the request of the client's auditors, about claims or possible claims against or by the client, for the purpose of auditing the client's financial statements. The JPS establishes protocols for the inquiry, and for the law firm's response, which are intended to prevent the inadvertent waiver of privilege when information is disclosed to the auditors by clients or by the law firm at the client's request.
Q. 2	**The JPS has been updated for the first time since 1978. What has changed?**
A.	The objectives of the 1978 JPS apply equally today – to protect privilege and to keep lawyers from becoming involved in a joint undertaking with the auditor. Also of concern is the impact of the process on lawyers' time and the cost to the client. Although new financial reporting standards initially triggered the review of the JPS, like the 1978 version, the updated JPS does not require lawyers to consider the applicable financial reporting framework when responding to an audit inquiry. A significant change is the express inclusion of in-house counsel in the scope of the JPS, recognizing the expanded role of in-house counsel in client matters. Other updates aim to resolve concerns expressed by the legal profession regarding communication protocols with the auditors, including with respect to the timing of inquiries and responses.
Q. 3	**How does the JPS protect privilege over the information the lawyer provides to the auditor?**
A.	The JPS is a risk management tool; following its protocols reduces (but does not eliminate) the risk of inadvertently waiving privilege. The JPS reduces this risk by specifying that: 1) the client addresses the law firm and the law firm addresses the client, not the auditor, in communications regarding audit inquiries (although in some instances those communications might be sent directly to the auditor); 2) the law firm's response is limited to an assessment of the client's description of claims and possible claims and the reasonableness of the client's evaluation of those claims; 3) the law firm will not disclose in its response possible claims that have not been included in the inquiry letter by the client; and 4) the inquiry letter and response letter are intended to be and to remain confidential and privileged communications, provided to the auditor for the limited purpose of auditing the client's financial statements.

Q. 4	**Are the JPS protocols mandatory?**
A.	The JPS protocols offer guidance to the legal profession; they are instructive, and informative as to the standards that will be followed by the auditors, but are not mandatory for the legal profession as the CBA does not have the authority to set standards and the law of privilege is established by case law.
Q. 5	**What are the roles of the client (management), the law firm and the auditor in this process?**
A.	The auditor determines whether it is necessary to send an audit inquiry letter to the law firm in order to collect sufficient appropriate audit evidence. If so, the client is responsible for drafting the inquiry letter, including the description and evaluation of claims and possible claims by and against it (with respect to estimated gain or loss), in accordance with the requirements of the applicable financial reporting framework. The auditor reviews the inquiry letter for compliance with the JPS and with the applicable financial reporting framework before it is sent to the law firm. The auditor may also be involved in discussions with the client and law firm if the law firm disagrees with or is unclear regarding the client's evaluations upon receipt of the inquiry letter. The law firm is responsible for: 1) possibly answering questions from the client about the drafting of the inquiry letter; 2) acknowledging receipt of the inquiry letter; 3) checking its records to identify claims and possible claims involving the client; 4) communicating with the client if there are possible claims omitted from the inquiry letter to ensure the client is aware of its obligation to disclose possible claims; 5) communicating with the client if the law firm disagrees with or is unclear regarding the client's evaluations; 6) responding to the inquiry letter with its assessment of the client's evaluation of the listed claims and possible claims , and specifying any outstanding omitted claims, by the response date indicated in the inquiry letter (usually 5 business days after the effective date of response) or by another agreed upon response date; and 7) providing an updated response to the inquiry letter, if requested, by the response date indicated, which will also be 5 business days after the effective date of response unless circumstances warrant an earlier response. An amended inquiry letter that includes new claims or possible claims or amended evaluations will be considered a new inquiry letter that will follow the same protocols as the initial inquiry letter.
Q. 6	**What are the "effective date of response" and "response date"?**
A.	The "effective date of response" is the date as of which the response letter covers claims and possible claims involving the client. The "response date" is the deadline for the law firm's response letter, which will usually be 5 business days after the effective date of response. We heard from the legal profession that the deadline was often the same date as the effective date of response, even though the law firm might need several days after the effective date of response to collect information and prepare the response letter. The new JPS reaffirms that law firms must have adequate time to prepare response letters.

Q. 7	**What do I do if the auditor follows up with an updated letter or asks for an updated response? Sometimes not enough time is allowed to answer.**
A.	We heard that requests from auditors for "quick updates", sometimes on very short timeframes (and sometimes informally, by phone), were becoming more common. The new JPS establishes that an updated response to the initial inquiry letter will require the same level of rigour as the first response, unless the update request pertains to only a part of the inquiry letter or there are special circumstances that justify a compressed timeframe. Also, if there are changes to the inquiry letter, such as new claims or amended evaluations (referred to in the new JPS as a "supplementary or amended inquiry letter"), it will be treated as a new inquiry letter that will follow the same protocols as the first inquiry letter.
Q. 8	**What happens if possible claims are omitted from the inquiry letter?**
A.	The law firm is expected to discuss omitted possible claims with the client, to ensure they are aware of their disclosure obligations. However the law firm should not include such identified possible claims in its response letter or otherwise disclose them to the auditor. If the client chooses to disclose those matters, it may send a supplementary or amended inquiry letter.
Q. 9	**How is the process different when the inquiry letter is directed to in-house counsel?**
A.	It is not different. In-house counsel will receive the inquiry letter from management of the entity (the client) and has the same responsibilities (set out in answer to Q. 5 above) as external counsel.
Q. 10	**But isn't that artificial? How do we protect against the common situation where in-house is also acting in management capacity, by helping to draft the inquiry letter or otherwise?**
A.	It appears artificial. However, it is a necessary construct to protect privilege and to support in-house counsel in their efforts to fulfill their professional obligations. Communications between management and in-house counsel for the purpose of obtaining legal advice are privileged, and auditors are not entitled to review those communications as part of the audit process. Including in-house counsel in the JPS ensures that only the information needed to collect sufficient appropriate audit evidence is provided and then only in accordance with the JPS protocols. While it is likely that in-house counsel will assist with drafting the inquiry letter, it is contemplated in the JPS that external counsel might do the same for a client.
Q. 11	**Do I need to understand all of the different financial reporting frameworks to fulfill my obligations?**
A.	No. The client prepares its evaluations in the inquiry letter in accordance with the applicable financial reporting framework and the auditor reviews the letter for compliance with that framework. The law firm need only assess the reasonableness of the evaluation based on its knowledge of the matter and its professional insight and experience in litigation and the settlement of claims.
Q. 12	**My clients sometimes contact me for help with the evaluations of matters to include in the inquiry letter. Won't I need to make reference to the financial reporting frameworks for that?**
A.	Clients may contact you when drafting the inquiry letter with questions related to your experience in litigation and the settlement of claims and possible claims. If the client's questions relate to the requirements of the applicable financial reporting framework, you should refer the client to the auditor for assistance.