

This ED is presented to the Board for the first time

Agenda Item 12(h).2
AUASB Meeting 23-24 February 2009
Marked Up Version

EXPOSURE DRAFT

ED 02/09
(February 2009)

**Proposed Auditing Standard
ASA 501
*Audit Evidence – Specific
Consideration for Selected
Items (Revised and
Redrafted)*
(Re-issuance of ASA 501 and
ASA 508)**

Issued for Comment by the **Auditing and Assurance Standards Board**

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Australian Government

Auditing and Assurance Standards Board

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by no later than 31 March 2009. Comments should be addressed to:

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A copy of all non-confidential submissions will be placed on public record on the AUASB website: www.auasb.gov.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AUASB website: www.auasb.gov.au. Alternatively, any individual or organisation may obtain one printed copy of this Exposure Draft without charge until no later than 31 March 2009 by contacting:

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ISSN 1030-603X

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

CONTENTS

PREFACE

AUTHORITY STATEMENT

	<i>Paragraphs</i>
Application	Aus0.1-Aus0.2
Operative Date	Aus0.3
Introduction	
Scope of this ASA.....	1
Effective Date	2
Objective(s)	3
Definition(s)	
Requirements	
Inventory	4-8
Litigation and Claims	9-12
Segment Information	13
Application and Other Explanatory Material	
Inventory	A1-A16
Litigation and Claims	A17-A25
Segment Information	A26-A27
Conformity with International Standards on Auditing	

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

PREFACE

Reasons for Issuing ED 02/09

The Auditing and Assurance Standards Board (AUASB) is proposing to re-issue Auditing Standards ASA 501 *Existence and Valuation of Inventory* and ASA 508 *Enquiry Regarding Litigation and Claims* as one Auditing Standard, pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Australian Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC), has undertaken a programme to redraft, in “clarity” format, the entire suite of International Standards on Auditing (ISAs). In some cases, and in accordance with normal practice, the ISAs have been revised in addition to being redrafted. The redrafted ISAs are effective for audits of financial statements for periods beginning on or after 15 December 2009.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the IAASB for the revision and enhancement of the ISAs and to make appropriate consequential amendments to the Australian Auditing Standards. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Main Proposals

This proposed Auditing Standard establishes mandatory Requirements and provides Application and Other Explanatory Material regarding ~~specific considerations by the auditor in obtaining sufficient appropriate audit evidence with respect to certain aspects of inventory, litigation and claims involving the entity and segment information in an audit of a financial report.~~

Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 January 2010.

Main changes from existing ASA's ASA 501 *Existence and Valuation of Inventory (April 2006)* and ASA 508 *Enquiry Regarding Litigation and Claims (April 2006)*

The main differences between this proposed Auditing Standard and the Auditing Standards that it supersedes, ASA 501 *Existence and Valuation of Inventory* (April 2006) and ASA 508 *Enquiry Regarding Litigation and Claims* (April 2006), are included in the Tables of Differences provided as an attachment to this Exposure Draft.

Request for Comments

Comments are invited on this Exposure Draft of the proposed re-issuance of Auditing Standards ASA 501, *Existence and Valuation of Inventory* and ASA 508, *Enquiry Regarding Litigation and Claims* by no later than 31 March 2009. The AUASB is seeking comments on the main changes from the existing ASA 501 and ASA 508. In addition, respondents are asked to consider and respond to the following questions:

1. Have applicable laws and regulations been appropriately addressed in the proposed standard?
2. Are there any references to relevant laws or regulations that have been omitted?
3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

4. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the Requirements of this proposed Auditing Standard? If there are significant costs, do these outweigh the benefits to the users of audit services?
5. Are there any other significant public interest matters that constituents wish to raise?

The AUASB prefers that respondents express a clear opinion on whether the main changes to the Requirements of this proposed Auditing Standard are supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the above matters. The AUASB regards both supportive and critical comments as essential to a balanced review of the Auditing Standard.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 501 *Audit Evidence – Specific Consideration for Selected Items* (Revised and Redrafted) pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA ~~<TypeHere>~~, 100 Preamble to the AUASB Standards, which sets out the intentions of the AUASB on how the Australian Auditing Standards are to be understood, interpreted and applied.

AUDITING STANDARD ASA 501

Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted)

Application

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with ~~Part 2M.3~~ of the *Corporations Act 2001*; and
 - (b) an audit of a financial report for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

Operative Date

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

Introduction

Scope of this ASA

1. This Auditing Standard deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with ASA 330 (Revised and Redrafted),¹ ASA 500 (Revised and Redrafted)² and other relevant Australian Auditing Standards, with respect to certain aspects of inventory, litigation and claims involving the entity, and segment information in an audit of financial report.

Effective Date

2. [Deleted by the AUASB. Refer Aus 0.3]

¹ ~~ASA 330 (Revised and Redrafted); “The Auditor’s Responses to Assessed Risks.”~~

² ~~ASA 500 (Revised and Redrafted); “Audit Evidence.”~~

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the:
- (a) Existence and condition of inventory;
 - (b) Completeness of litigation and claims involving the entity; and
 - (c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.

Requirements

Inventory

4. When inventory is material to the financial ~~statements~~report, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:
- (a) Attendance at physical inventory counting, unless impracticable, to: (Ref: Para. A1-A3)
 - (i) Evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting; (Ref: Para. A4)
 - (ii) Observe the performance of management’s count procedures; (Ref: Para. A5)
 - (iii) Inspect the inventory; and (Ref: Para. A6)
 - (iv) Perform test counts; and (Ref: Para. A7-A8)
 - (b) Performing audit procedures over the entity’s final inventory records to determine whether they accurately reflect actual inventory count results.
5. If physical inventory counting is conducted at a date other than the date of the financial ~~statements~~report, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

the count date and the date of the financial ~~statements-report~~ are properly recorded. (Ref: Para. A9-A11)

6. If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions.
7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with ~~ASA~~ 705 (Revised and Redrafted).³ (Ref: Para. A12-A14)
8. When inventory under the custody and control of a third party is material to the financial ~~statements-report~~, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
 - (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (Ref: Para. A15)
 - (b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16)

Litigation and Claims

9. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including: (Ref: Para. A17-A19)
 - (a) ~~E~~nquiry of management and, where applicable, others within the entity, including in-house legal counsel;
 - (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
 - (c) Reviewing legal expense accounts. (Ref: Para. A20)

³ ~~ASA~~ 705 (Revised and Redrafted): *“Modifications to the Opinion in the Independent Auditor’s Report.”*

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

10. If 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, the auditor shall **endeavour to**, in addition to the procedures required by other **ASAs**, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of **enquiry**, prepared by management and sent by the auditor, requesting the entity's external legal counsel to communicate directly with the auditor. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures. (Ref: Para. A21-A25)
11. If:
- (a) management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of **enquiry**, or is prohibited from responding; and
 - (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures,
- the auditor shall modify the opinion in the auditor's report in accordance with **ASA 705 (Revised and Redrafted)**.

Written Representations

12. The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial **statements-report** have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

Segment Information

13. The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:
(Ref: Para. A26)

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

- (a) Obtaining an understanding of the methods used by management in determining segment information, and: (Ref: Para. A27)
 - (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - (ii) Where appropriate, testing the application of such methods; and
- (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.

* * *

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Application and Other Explanatory Material

Inventory

Attendance at Physical Inventory Counting (Ref: Para. 4(a))

- A1. Management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of the financial ~~statements-report~~ and, if applicable, to ascertain the reliability of the entity's perpetual inventory system.
- A2. Attendance at physical inventory counting involves:
- Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
 - Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
 - Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

- A3. Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs 4-8 of this ~~ISAASA~~) include, for example:
- The risks of material misstatement related to inventory.
 - The nature of the internal control related to inventory.
 - Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
 - The timing of physical inventory counting.
 - Whether the entity maintains a perpetual inventory system.
 - The locations at which inventory is held, including the materiality of the inventory and the risks of material

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

misstatement at different locations, in deciding at which locations attendance is appropriate. ~~ISA-ASA~~ 600 (Revised and Redrafted)⁴ deals with the involvement of other auditors and accordingly may be relevant if such involvement is with regards to attendance of physical inventory counting at a remote location.

- Whether the assistance of an auditor's expert is needed. ~~ISA-ASA~~ 620 (Revised and Redrafted)⁵ deals with the use of an auditor's expert to assist the auditor to obtain sufficient appropriate audit evidence.

Evaluate Management's Instructions and Procedures (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example:

- The application of appropriate control activities, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and re-count procedures.
- The accurate identification of the stage of completion of work in progress, of slow moving, obsolete or damaged items and of inventory owned by a third party, for example, on consignment.
- The procedures used to estimate physical quantities, where applicable, such as may be needed in estimating the physical quantity of a coal pile.
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut-off date.

⁴ ~~ISA-ASA~~ 600 (Revised and Redrafted); *“Special Considerations—Audits of a Group Financial Statements Report (Including the Work of the Component Auditors).”*

⁵ ~~ISA-ASA~~ 620 (Revised and Redrafted); *“Using the Work of an Auditor's Expert.”*

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Observe the Performance of Management’s Count Procedures (Ref: Para. 4(a)(ii))

- A5. Observing the performance of management’s count procedures, for example those relating to control over the movement of inventory before, during and after the count, assists the auditor in obtaining audit evidence that management’s instructions and count procedures are adequately designed and implemented. In addition, the auditor may obtain copies of cut-off information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

Inspect the Inventory (Ref: Para. 4(a)(iii))

- A6. Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in identifying, for example, obsolete, damaged or ageing inventory.

Perform Test Counts (Ref: Para. 4(a)(iv))

- A7. Performing test counts, for example by tracing items selected from management’s count records to the physical inventory and tracing items selected from the physical inventory to management’s count records, provides audit evidence about the completeness and the accuracy of those records.
- A8. In addition to recording the auditor’s test counts, obtaining copies of management’s completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity’s final inventory records accurately reflect actual inventory count results.

Physical Inventory Counting Conducted Other than At the Date of the Financial ~~Statements-Report~~ (Ref: Para. 5)

- A9. For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial ~~statementsreport~~. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial ~~statements-report~~ is appropriate for audit purposes. ~~ASA~~ 330 (~~Revised and~~ Redrafted)

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

establishes requirements and provides guidance on substantive procedures performed at an interim date.⁶

- A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.
- A11. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:
- Whether the perpetual inventory records are properly adjusted.
 - Reliability of the entity's perpetual inventory records.
 - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

Attendance at Physical Inventory Counting Is Impracticable (Ref: Para. 7)

- A12. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in [ISA-ASA 200](#) (Revised and Redrafted),⁷ the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.
- A13. In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased

⁶ [ISA-ASA 330](#) (Redrafted), paragraphs 23-24.

⁷ [ISA-ASA 200](#) (Revised and Redrafted); “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with [International Standards on Australian Auditing Standards](#)”; paragraph A48.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

- A14. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, ~~ISA-ASA~~ 705 (Revised and Redrafted) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.⁸

Inventory under the Custody and Control of a Third Party

Confirmation (Ref: Para. 8(a))

- A15. ASA 505 (Revised and Redrafted)⁹ establishes requirements and provides guidance for performing external confirmation procedures.

Other Audit Procedures (Ref: Para. 8(b))

- A16. Depending on the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties, for example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral.

⁸ ~~ASA~~ 705 (Revised and Redrafted), paragraph 13.

⁹ ~~ISA-ASA~~ 505 (Revised and Redrafted), "External Confirmations."

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Litigation and Claims

Completeness of Litigations and Claims (Ref: Para. 9)

- A17. Litigation and claims involving the entity may have a material effect on the financial ~~statements-report~~ and thus may be required to be disclosed or accounted for in the financial ~~statementsreport~~.
- A18. In addition to the procedures identified in paragraph 9, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.
- A19. Audit evidence obtained for purposes of identifying litigation and claims that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation and claims. ~~ISA~~ ~~ASA~~ 540 (Revised and Redrafted)¹⁰ establishes requirements and provides guidance relevant to the auditor's consideration of litigation and claims requiring accounting estimates or related disclosures in the financial ~~statementsreport~~.

Reviewing Legal Expense Accounts (Ref: Para. 9(c))

- A20. Depending on the circumstances, the auditor may judge it appropriate to examine related source documents, such as invoices for legal expenses, as part of the auditor's review of legal expense accounts.

Communication with the Entity's External Legal Counsel (Ref: Para. 10-11)

- A21. Direct communication with the entity's external legal counsel assists the auditor in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management's estimates of the financial implications, including costs, are reasonable.
- A22. In some cases, the auditor may seek direct communication with the entity's external legal counsel through a letter of general ~~inquiry-enquiry~~. For this purpose, a letter of general ~~inquiry-enquiry~~ requests the entity's external legal counsel to inform the auditor of any litigation and claims that the counsel is aware of, together with

¹⁰ ~~ISA-ASA~~ 540 (Revised and Redrafted); ~~"Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures."~~

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

an assessment of the outcome of the litigation and claims, and an estimate of the financial implications, including costs involved.

A23. If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general ~~inquiry~~~~enquiry~~, for example if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication through a letter of specific ~~inquiry~~~~enquiry~~. For this purpose, a letter of specific ~~inquiry~~~~enquiry~~ includes:

- (a) A list of litigation and claims;
- (b) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
- (c) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

[See Aus Appendix 1 for an example of a letter of specific enquiry.](#)

A24. In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, where:

- The auditor determines that the matter is a significant risk.
- The matter is complex.
- There is disagreement between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

A25. In accordance with ~~ISA-ASA~~ 700 (~~Revised and Redrafted~~),¹¹ the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit

¹¹ ~~ISA-ASA~~ 700 (~~Revised and Redrafted~~); *Forming an Opinion and Reporting on Financial Statements Reports*,²² paragraph 42.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

evidence on which to base the auditor's opinion on the financial ~~statements report~~. Audit evidence about the status of litigation and claims up to the date of the auditor's report may be obtained by ~~inquiry enquiry~~ of management, including in-house legal counsel, responsible for dealing with the relevant matters. In some instances, the auditor may need to obtain updated information from the entity's external legal counsel.

Segment Information (Ref: Para. 13)

A26. Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial ~~statements report~~. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial ~~statements report~~ taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis.

Understanding of the Methods Used by Management (Ref: Para. 13(a))

A27. Depending on the circumstances, example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- Sales, transfers and charges between segments, and elimination of inter-segment amounts.
- Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- The allocation of assets and costs among segments.
- Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Conformity with International Standards on Auditing

This Auditing Standard conforms with International Standard on Auditing ISA [501 \(Redrafted\)](#), issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix “Aus”.

Compliance with this Auditing Standard enables compliance with ISA [501](#).

Draft

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

Aus Appendix 1

(Ref: Para. 10 and Para. A23)

EXAMPLE OF A ~~A REPRESENTATION~~ LETTER OF SPECIFIC ENQUIRY
TO AN ~~LAWYER~~ EXTERNAL LEGAL COUNSEL
(FOR AN AUDIT CLIENT)

(~~Client~~ Letterhead ~~of Client~~)

(Date)

(Name and Address of ~~Lawyer~~ External Legal Counsel)

Dear ...

In connection with the preparation and audit of the financial report of ~~the~~ (name of company) (and the following subsidiaries and/or divisions) for the reporting period ended (date) we request that you provide to this company, at our cost, the following information:

- 1 Confirmation that you are acting for the company (and the above-named subsidiaries and/or divisions) in relation to the matters mentioned below and that the directors' description and estimates of the amounts of the financial settlement (including costs and disbursements) which might arise in relation to those matters are in your opinion reasonable.

Name of Company (subsidiary or division)	Directors' Description of Matter (including current status)	Directors' Estimate of the Financial Settlement (inclusive of costs and disbursements)
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- 2 Should you disagree with any of the information included in 1 above, please comment on the nature of your disagreement.
- 3 In addition to the above, a list of open files that you maintain in relation to the company (and the above mentioned subsidiaries and/or divisions).
- 4 In relation to the matters identified under 2 and 3 above, we authorise you to discuss these matters with our auditor (name and address), if requested, and at our cost.

Proposed Auditing Standard ASA 501
Audit Evidence – Specific Consideration for Selected Items (Revised and Redrafted) (Re-issuance of ASA 501 and ASA 508)

It is understood that:

- (a) the company (and the above-named subsidiaries and/or divisions) may have used other lawyers in certain matters;
- (b) the information sought relates only to information relating to legal matters referred to your firm (including branches or subsidiaries) which were current at any time during the above-mentioned reporting period, or have arisen since the end of the reporting period and up to the date of your response;
- (c) unless separately requested in writing, you are not responsible for keeping the auditors advised of any changes after the date of your reply;
- (d) you are only required to respond on matters referred to you as lawyers for the company (and the above-mentioned subsidiaries and/or divisions), not on those within your knowledge solely because of the holding of any office as director, secretary or otherwise of the company (and the above-mentioned subsidiaries and/or divisions) by a consultant, partner or employee of your firm; and
- (e) your reply is sought solely for the information of, and assistance to, this company in connection with the audit of, and report with respect to, the financial report of the company (and the above-mentioned subsidiaries and/or divisions) and will not be quoted or otherwise referred to in any financial report or related documents of the company (and the above-mentioned subsidiaries and/or divisions) nor will it be furnished to any governmental agency or other person, subject to specific legislative requirements, without the prior written consent of your firm.

Your prompt assistance in this matter will be appreciated. If you are unable to confirm or provide the information requested above, please advise us and our auditor the reasons for any limitation or impediment to fulfilling this request.

~~Would you please~~ please forward a signed copy of your reply directly to our auditors, (name) at (address), by (date).

Yours faithfully,

(Signature and Title of client)

Tables of Differences — ASA 501 (Revised and Redrafted) and Extant ASA’s ASA 501 and ASA 508

Underlying Standard

ISA 501 (Redrafted) is used as the underlying Auditing Standard for the purpose of re-drafting this proposed Auditing Standard. The underlying Auditing Standard will be amended for the following matters:

- Australian Laws and Regulations (including the *Corporations Act 2001*);
- Changes considered necessary because this Auditing Standard is a legislative instrument; and
- Changes considered necessary in the public interest.

Summary of Main Differences — ASA 501 (Revised and Redrafted) and Extant Standards ASA 501 and ASA 508

The table below details the main differences (excluding editorial amendments) between this proposed Auditing Standard and extant ASAs 501 and 508.

Requirements in ASA (Revised and Redrafted) not in Extant ASA

Item #	ASA (Revised and Redrafted) Para. #	ASA (Revised and Redrafted) Requirements	Commentary
Objective			
1	3	The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the: (a) Existence and condition of inventory; (b) Completeness of litigation and claims involving the entity; and (c) Presentation and disclosure of segment information in accordance with the applicable financial reporting framework.	New Objective.
Inventory			
2	4	When inventory is material to the financial report , the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:	Unshaded text – Extant ASA 501 para 11– equivalent Requirements.

Item #	ASA (Revised and Redrafted) Para. #	ASA (Revised and Redrafted) Requirements	Commentary
		(a) Attendance at physical inventory counting, unless impracticable, to : (Ref: Para. A1-A3)	Shaded text equivalent general audit materiality requirement. [ASA 320 (Revised and Redrafted) and ASA 200 (Revised and Redrafted) para 6]
3	4	a) ... (i) Evaluate management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory counting; (Ref: Para. A4) (ii) Observe the performance of management’s count procedures; (Ref: Para. A5) (iii) Inspect the inventory; and (Ref: Para. A6) (iv) Perform test counts; and (Ref: Para. A7-A8)	Elevation of Extant ASA Explanatory Guidance [Extant ASA 501 para 7-8, para 12, para 18, para 23-24, and para 27]
4	5	If physical inventory counting is conducted at a date other than the date of the financial report, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial report are properly recorded. (Ref: Para. A9-A11)	Elevation of extant ASA Explanatory Guidance [Extant ASA 501 para 26—equivalent Explanatory Guidance]
5	8	When inventory under the custody and control of a third party is material to the financial report, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following: (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity. (Ref: Para. A15) (b) Perform inspection or other audit procedures appropriate in the circumstances. (Ref: Para. A16)	Elevation of extant ASA Explanatory Guidance [Extant ASA 501 para 29—equivalent Explanatory Guidance]

Item #	ASA (Revised and Redrafted) Para. #	ASA (Revised and Redrafted) Requirements	Commentary
Litigation and Claims			
6	9	The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including: (Ref: Para. A17-A19) (a) Enquiry of management and, where applicable, others within the entity, including in-house legal counsel; (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and (c) Reviewing legal expense accounts. (Ref: Para. A20)	Elevation of extant ASA Explanatory Guidance [Extant ASA 508 para 8 and para 9—equivalent Explanatory Guidance].
7	10	If 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, the auditor shall <u>endeavour to</u> , in addition to the procedures required by other ASAs, seek direct communication with the entity’s external legal counsel. The auditor shall do so through a letter of <u>enquiry</u> , prepared by management and sent by the auditor, requesting the entity’s external legal counsel to communicate directly with the auditor. <u>If law, regulation or the respective legal professional body prohibits the entity’s external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.</u> (Ref: Para. A21-A25)	Shaded text has no extant ASA equivalent. Unshaded text – extant ASA 508 para 11 and para 13 – equivalent Requirements.
8	11	If: (a) management refuses to give the auditor permission to communicate or meet with the entity’s external legal counsel, or the entity’s external legal counsel refuses to respond appropriately to the letter of enquiry, or is prohibited from responding; and (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures,	Elevation of extant ASA Explanatory Guidance [Extant ASA 508 para 26-27 and para 31-32 —equivalent Explanatory Guidance].

Item #	ASA (Revised and Redrafted) Para. #	ASA (Revised and Redrafted) Requirements	Commentary
		the auditor shall modify the opinion in the auditor’s report in accordance with ASA 705 (Revised and Redrafted).	
<i>Written Representations</i>			
9	12	The auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial report have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.	Equivalent Requirement in extant ASA 580 (Revised and Redrafted) <i>Management Representations</i> which states: <i>Information Provided to the Auditor</i> 11. <i>The auditor shall request management to provide a written representation that it has provided the auditor with all relevant information agreed in the terms of the audit engagement, and that all transactions have been recorded and are reflected in the financial report.</i>
Segment Information			
10	13	The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by: (Ref: Para. A26) (a) Obtaining an understanding of the methods used by management in determining segment information, and: (Ref: Para. A27) (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and (ii) Where appropriate, testing the application of such methods; and (b) Performing analytical procedures or other audit procedures appropriate in the circumstances.	No extant ASA equivalent. However, where segment reporting applies, the auditor would ordinarily perform these procedures, in order to be able to fulfil the Requirements of the following standards: <ul style="list-style-type: none"> • ASA 200 (Revised and Redrafted) para 17 • ASA 500 (Revised and Redrafted) para 6 • ASA 700 (Revised and Redrafted) para 10-15

Requirements in Extant ASA not in ASA (Revised and Redrafted)

Item #	Extant ASA Para. #	Extant ASA Requirement	Commentary
Not Retained in ASA [Revised & Redrafted]			
Extant ASA 501 <i>Existence and Valuation of Inventory</i>			
1	5	The auditor shall obtain sufficient appropriate audit evidence regarding the existence and valuation of inventory material to the financial report.	It is proposed that the requirements regarding valuation of inventory in extant ASA 501 not be carried forward into ASA 501 (Revised and Redrafted) because they are covered by requirements contained in other standards. For example: <ul style="list-style-type: none"> • ASA 200 (Revised and Redrafted) requirement to obtain sufficient appropriate audit evidence; • ASA 500 (Revised and Redrafted) requirement to design and perform audit procedures; • ASA 330 (Revised and Redrafted) requirement to identify and assess risks at the assertion level.
2	30	AND The auditor shall evaluate the methods used by management in the valuation of inventory.	
3	31	AND The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the valuation of inventory.	
4	19	If the entity uses procedures to estimate the physical quantity of inventory that is material, the auditor shall design and perform audit procedures to be satisfied with the reasonableness of those procedures.	Covered by the Requirements in ASA 540 <i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i> (Revised and Redrafted).
ASA 508 Enquiry Regarding Litigation and Claims			
5	5	... (a) ... (b) the probability of any material revenue or expense arising from such matters and the estimated amount thereof; and	Covered by the Requirements contained in other ASAs (Revised and Redrafted), for example: <ul style="list-style-type: none"> • ASA 200 (Revised and Redrafted) requirement to obtain sufficient appropriate audit evidence; • ASA 500 (Revised and Redrafted) requirement to design and perform audit procedures; and

Item #	Extant ASA Para. #	Extant ASA Requirement	Commentary
		(c) the adequacy of the accounting treatment of such matters including their disclosure in the financial report.	<ul style="list-style-type: none"> ASA 540 (Revised and Redrafted) para 18-20 requirements regarding the reasonableness and disclosure of accounting estimates.
<i>Employee and/or Third party Lawyers</i>			
7	22	If a response from the entity’s lawyers contains a material disagreement with management’s original evaluation of a particular matter, the auditor shall seek discussions with management and the entity’s lawyers, unless management subsequently agrees with the lawyers’ evaluation.	<p>Covered by other ASAs (for example, ASA 200 (Revised and Redrafted)) and the guidance contained in ASA 501 (Revised and Redrafted) para A24.</p> <p>In instances where a legal counsel’s response indicates there is disagreement between management and legal counsel the auditor would ordinarily perform further audit procedures, including discussions with management and legal counsel to resolve the matter.</p>
Related Procedures			
8	33	The auditor shall enquire of management about new legal matters referred to the entity’s lawyers subsequent to the date of the request for a representation letter to the entity’s lawyers and prior to signing the auditor’s report.	<p>Covered by ASA 580 (Revised and Redrafted) para 14 (and related guidance in para A17-A20) and ASA 700 (Revised and Redrafted) para 41.</p> <p>ASA 501 (Revised and Redrafted) para A25 contains equivalent guidance.</p>
9	35	If audit procedures lead to the discovery of matters of a legal nature not previously identified by management, the auditor shall consider the impact of each of the matters on the financial report.	Covered by other standards, for example, ASA 200 (Revised and Redrafted) and ASA 700 (Revised and Redrafted) para 41.