

Compiled Auditing Standard

ASA 502

(June 2011)

Auditing Standard ASA 502
Audit Evidence—Specific
Considerations for Litigation
and Claims

This compilation was prepared on 27 June 2011 taking into account amendments made by ASA 2011-1

Prepared by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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ISSN 1833-4393

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COMPILATION DETAILS

Auditing Standard ASA 502 *Audit Evidence – Specific Considerations for Litigation and Claims* as Amended

This compilation takes into account amendments made up to and including 27 June 2011 and was prepared on 27 June 2011 by the Auditing and Assurance Standards Board (AUASB).

This compilation is not a separate Auditing Standard made by the AUASB. Instead, it is a representation of ASA 502 (October 2009) as amended by another Auditing Standard which is listed in the Table below.

Table of Standards

Standard	Date made	Operative date
ASA 502	27 October 2009	1 January 2010
ASA 2011-1	27 June 2011	1 July 2011

Table of Amendments

Paragraph affected	How affected	By ... [paragraph]
Sub-heading above Para. A4	Amended	ASA 2011-1 [36]

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AUTHORITY STATEMENT

Auditing Standard ASA 502 *Audit Evidence—Specific Considerations for Litigation and Claims* (as amended at 27 June 2011) is set out in paragraphs 1 to Aus A9.3 and [Aus]Appendix 1.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. This Auditing Standard is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

Dated: 27 June 2011

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 502

The Auditing and Assurance Standards Board (AUASB) made Auditing Standard ASA 502 *Audit Evidence – Specific Considerations for Litigation and Claims*, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*, on 27 October 2009.

This compiled version of ASA 502 incorporates subsequent amendments contained in another Auditing Standard made by the AUASB up to and including 27 June 2011 (see Compilation Details).

AUDITING STANDARD ASA 502

Audit Evidence—Specific Considerations for Litigation and Claims

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 the *Corporations Act 2001*; and
 - (b) an audit of a financial report, or a complete set of financial statements, 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. [Note: For operative dates of paragraphs changed or added by an amending Standard, see Compilation Details.]

Introduction

Scope of this Auditing Standard

1. This Auditing Standard deals with specific considerations by the auditor in obtaining sufficient appropriate audit evidence in accordance with ASA 330,¹ ASA 500² and other relevant Australian Auditing Standards, with respect to litigation and claims involving the entity in an audit of a financial report.

Effective Date

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

¹ See ASA 330 *The Auditor's Responses to Assessed Risks*.

² See ASA 500 *Audit Evidence*.

Objective

2. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the completeness of litigation and claims involving the entity.

Requirements

Completeness of Litigation and Claims

3. 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. A1-Aus A4.1)
 - (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. A4)

Communication with the Entity's Legal Counsel

External Legal Counsel

4. 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 Australian Auditing Standards, 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. A5-A8)

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In-house and/or External Legal Counsel

- Aus 5.1 Where in-house legal counsel has the primary responsibility for litigation and claims and is in the best position to corroborate management's representations, the auditor shall endeavour to obtain a representation letter from the in-house legal counsel, seeking information similar to that sought from the entity's external legal counsel.
(Ref: Para. Aus A8.1-Aus A8.2)

Legal Counsel's Response

- Aus 5.2 If a response from the entity's external or internal legal counsel contains a material disagreement with management's original evaluation of a particular matter, the auditor shall seek discussions with management and the entity's legal counsel, unless management subsequently agrees with the legal counsel's evaluation.
(Ref: Para. Aus A8.3-Aus A8.6)

5. 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 (Ref: Para. Aus 8.7-Aus 8.8)
 - (b) the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures,
(Ref: Para. Aus A8.9-Aus A8.10)

the auditor shall modify the opinion in the auditor's report in accordance with ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: Para. Aus A8.11)

Written Representations

6. 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 accounted for and disclosed in accordance with the applicable financial reporting framework.
(Ref: Para. Aus A8.12-Aus A8.13)

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Related Procedures

- Aus 6.1 The auditor shall enquire of management about new litigation and claims referred to the entity's legal counsel subsequent to the date of the request for a letter of enquiry to the entity's legal counsel and prior to signing the auditor's report. (Ref: Para. A9-Aus A9.1)
- Aus 6.2 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. (Ref: Para. Aus A9.2-Aus A9.3)

* * *

Application and Other Explanatory Material

Completeness of Litigation and Claims (Ref: Para. 4)

- A1. Litigation and claims involving the entity may have a material effect on the financial report and thus may be required to be disclosed or accounted for in the financial report.
- Aus A1.1 It is the responsibility of those charged with governance of an entity to adopt policies and procedures to identify, evaluate, record and report on the outcome of any material litigation and claims. However, since the factors that would be considered in the accounting for and reporting of litigation and claims are within the direct knowledge and control of the management of an entity, management is the primary source of information. Ordinarily, the auditor would seek audit evidence from different sources to corroborate management's assertions.
- A2. In addition to the procedures identified in paragraph 4, 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.
- Aus A2.1 The procedures identified in paragraphs 4 and A2 would ordinarily include the following:
- reviewing and discussing with management the procedures within the entity's internal control structure for identifying and recording litigation and claims and bringing them to the attention of management;
 - reviewing and discussing with management the procedures within the entity's internal control structure for the identification, control and recording of litigation and claims and associated revenues and expenses in appropriate accounts; and
 - obtaining and discussing with management:
 - (i) a list of litigation and claims, including a description of the matters and an estimate

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of their likely financial consequences;
and

- (ii) an analysis identifying litigation and claims.

Aus A2.2 Audit procedures that are undertaken for different purposes might also identify litigation and claims. Such procedures include:

- examining contracts, loan agreements, leases, insurance policies and claims, and other correspondence;
- reading minutes of meetings of the audit committee, shareholders and appropriate committees;
- obtaining information concerning guarantees from bank confirmations; and
- enquiries of management and other employees of the entity.

A3. 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. ASA 540* establishes requirements and provides guidance relevant to the auditor's consideration of litigation and claims requiring accounting estimates or related disclosures in the financial report.

Reviewing Legal Expense Accounts (Ref: Para. 4(c))

A4. 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.

Outcome of Litigation and Claims (Ref: Para. 4)

Aus A4.1 The procedures outlined in paragraphs A1-A4 are methods whereby the auditor can identify both material litigation

* See ASA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

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and claims and legal counsel who have been consulted by the entity. However, these procedures may not necessarily provide the auditor with sufficient appropriate audit evidence concerning the likely outcome of litigation and claims. Furthermore, the auditor ordinarily does not possess the skills necessary and is not in a position to make legal judgements concerning the likely outcome of litigation and claims.

Communication with the Entity's Legal Counsel (Ref: Para. 5-6)

External Legal Counsel (Ref: Para. 5)

- A5. 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.
- A6. In some cases, the auditor may seek direct communication with the entity's external legal counsel through a letter of general enquiry. For this purpose, a letter of general 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 an assessment of the outcome of the litigation and claims, and an estimate of the financial implications, including costs involved.
- A7. If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general 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 enquiry. For this purpose, a letter of specific 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

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considered by the entity's external legal counsel to be incomplete or incorrect.

Aus A7.1 An example of a letter of specific enquiry is included in [Aus] Appendix 1.

Aus A7.2 An auditor may in some cases request that management send a letter of enquiry to the entity's legal counsel who are not identified as currently handling the entity's litigation and claims. For example when the entity has changed legal counsel on a particular matter, or when legal counsel engaged by the entity has resigned, the auditor would consider the need for enquiries concerning the reasons for the change or resignation.

A8. 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.

In-house and/or External Legal Counsel (Ref: Para. Aus 5.1)

Aus A8.1 If both in-house and external legal counsel are involved in advising the entity on the same litigation and claims, the auditor would ordinarily seek a letter of enquiry from the legal counsel with the primary responsibility for that matter. However, there may be circumstances where the in-house legal counsel has primary responsibility, but the matter has involved substantial participation by an external legal counsel, and is of such significance that the auditor would consider obtaining a letter of enquiry from the external legal counsel to determine that their opinion does not differ materially from that of the in-house legal counsel.

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Aus A8.2 In circumstances where both in-house and external legal counsel have devoted substantial attention to litigation and claims involving the entity and primary responsibility rests with the external legal counsel, evidence obtained from an in-house legal counsel is not an adequate substitute for any information that the external legal counsel may refuse to furnish.

Legal Counsel's Response

Aus A8.3 Before relying on the opinion of either in-house legal counsel or external legal counsel, care should be exercised to ensure that conditions prevail which would make such reliance reasonable.*

Aus A8.4 If a disagreement between management and legal counsel is resolved after discussions, the auditor would ordinarily request the entity's legal counsel to confirm the details in writing to the auditor. (Ref: Para. Aus 5.2)

Aus A8.5 If the disagreement is not resolved, the auditor would ordinarily prepare a memorandum of the discussion and seek written confirmation from management and the entity's legal counsel that it is an accurate record of the discussion. In conjunction with evidence from other audit procedures, the auditor, under ASA 705, needs to consider the effect of such disagreement on the auditor's report.

Aus A8.6 If the response from the entity's legal counsel contains information that requires clarification, the auditor would ordinarily make further enquiries of management and the entity's legal counsel, as appropriate, and request clarification in writing.

Legal Counsel's Inability to Respond Comprehensively or Limitations in a Response (Ref: Para. 6(a))

Aus A8.7 If a response is not received from the entity's legal counsel, or the response received is incomplete, the auditor would ordinarily consider:

- (a) requesting management to contact the entity's legal counsel to either seek a complete answer to

* See ASA 500 for the applicable requirements and guidance on using the work of a management's expert.

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the original request, or an explanation for the lack of, or limitation in, a response, which ought to be sent directly to the auditor; or

- (b) making arrangements to discuss with management or the entity's legal counsel the reasons for the lack of, or limitation in, a response.

Aus A8.8 Due to the following circumstances it may be difficult to either obtain a response to a letter of enquiry or be provided with information about litigation and claims from the entity's legal counsel:

- (a) If the entity is involved in litigation, or litigation is anticipated or contemplated, relevant information about legal matters may be subject to legal professional privilege. Disclosure of this information in the letter of enquiry, directly to the auditor for the purposes of the audit of the entity's financial report, is not privileged. This may cause legal professional privilege attaching to the entity's communications with its legal counsel to be compromised, as information in the letter of enquiry might become discoverable in litigation proceedings.
- (b) Factors influencing the outcome of a legal matter may sometimes not be within the legal counsel's competence to judge, for example where there is no relevant or historical experience of the entity or other entities in similar matters, or where the litigation is at an early stage.
- (c) Due to material uncertainties, the entity's legal counsel may be unable to form a conclusion to corroborate management's representations regarding outstanding litigation and claims.

Alternative Audit Procedures (Ref: Para. 6(b))

Aus A8.9 Where the auditor has not obtained sufficient appropriate audit evidence as to a material financial report assertion regarding litigation and claims, under ASA 330, the auditor needs to consider whether alternative audit procedures can

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provide further audit evidence. Alternative audit procedures may include:

- (a) further enquiries of management or those charged with governance, about for instance the processes, procedures and assumptions they implement, adopt or make to ensure litigation and claims are recognised and disclosed in accordance with the applicable financial reporting framework;
- (b) where possible, making arrangements to discuss litigation and claims with management and the entity's legal counsel;
- (c) further review of documents in management's possession concerning litigation and claims, including the entity's board minutes; and
- (d) further examination of accounts rendered by the entity's external legal counsel.

Aus A8.10 The auditor may also consider any relevant legislation to assist in obtaining information about litigation and claims, including, for example:

- Section 310 of the *Corporations Act 2001* which entitles the auditor to a right of access at all reasonable times to the books of a company, registered scheme or disclosing entity, and to require from any officer information, explanations or other assistance for the purposes of the audit or review.
- When the entity is a disclosing entity, whether disclosure of any litigation and claims has been made in accordance with the continuous disclosure requirements under sections 674 or 675 of the *Corporations Act 2001*.

Other Audit Reporting Considerations (Ref: Para. 6)

Aus A8.11 In those circumstances where, due to uncertainties, the entity's legal counsel is unable to form a conclusion to corroborate management's representation, the auditor needs to consider the effect on the auditor's report arising from

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the extent of disclosure of the uncertainty in the financial report:

- (a) where the auditor considers that the disclosure of the uncertainty in the financial report is adequate, the auditor needs to consider including an Emphasis of Matter paragraph; in accordance with ASA 706,^{*} or
- (b) if in the auditor's opinion the disclosure of the uncertainty is inadequate or unreliable, a modified opinion needs to be expressed in accordance with ASA 705.

Written Representations (Ref: Para.7)

Aus A8.12 ASA 580[#] deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance, in an audit of a financial report. Appendix 2 of that Standard provides an illustrative example of a representation letter.

Aus A8.13 As management is the primary source of information regarding litigation and claims, the auditor is required to request management to provide written representations about such matters. Written representations from management provide audit evidence regarding litigation and claims that may have a material effect on the financial report.

Related Procedures (Ref: Para. Aus 7.1-Aus 7.2)

A9. In accordance with ASA 700,[†] the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial report. Audit evidence about the status of litigation and claims up to the date of the auditor's report may be obtained by 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.

^{*} See ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

[#] See ASA 580 *Written Representations*.

[†] See ASA 700 *Forming an Opinion and Reporting on a Financial Report*.

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- Aus A9.1 When new litigation or claims, which may have a material effect on the financial report, have been referred to the entity's legal counsel subsequent to sending the letter of enquiry to the entity's legal counsel and prior to signing the auditor's report, the auditor would ordinarily request management to prepare an additional letter of enquiry to the legal counsel regarding the new litigation or claims.
- Aus A9.2 When litigation and claims matters, which may have a material effect on the financial report, are discovered, which were not previously identified by management, the auditor would ordinarily inform management and request management to address further enquiries to, or arrange a meeting with, the entity's legal counsel or other relevant experts, at which the auditor would be present. In addition, the auditor needs to extend the auditor's audit procedures to ensure that sufficient appropriate audit evidence on which to form an opinion has been obtained. If, however, having regard to all the circumstances, the auditor is unable to obtain satisfaction that all the information required for the purposes of the audit has been received, the auditor considers the effect on the auditor's report.*
- Aus A9.3 If information comes to the auditor's attention that may indicate the existence of material liabilities resulting from litigation and claims on which management has not sought advice, the auditor ordinarily discusses the matter with those charged with governance. Depending on the circumstances, refusal by management to seek advice may be considered to be a limitation in the scope of the auditor's work.

* See ASA 705.

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Conformity with International Standards on Auditing

This Auditing Standard conforms with the Litigation and Claims sections (paragraphs 1-3, 9-12 and A17-A25) of International Standard on Auditing ISA 501 *Audit Evidence—Specific Considerations for Selected Items*, issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

The other paragraphs of ISA 501 relating to Inventory and Segment Information (paragraphs 4-8, 13, A1-A16 and A26-A27) are incorporated into ASA 501 *Audit Evidence—Specific Considerations for Inventory and Segment Information*.

The AUASB has decided to continue to issue ASA 502 as a separate Auditing Standard, in the same way that the previous standard, ASA 508 *Enquiry Regarding Litigation and Claims*, is a separate standard. ASA 508 contains requirements and guidance that the AUASB considers important to carry forward in the Australian Auditing Standards, and as a result, the revised standard is better suited to presentation as a separate standard.

This Auditing Standard contains all the requirements and guidance contained in ISA 501 relating to Litigation and Claims, as well as additional requirements and guidance that are contained in ASA 508. Paragraphs in this Auditing Standard that do not appear in the text of ISA 501 are identified with the prefix “Aus”.

Compliance with this Auditing Standard, in conjunction with ASA 501, enables compliance with ISA 501.

Table 1, following, shows how paragraphs in this Auditing Standard have been re-numbered, compared to the equivalent paragraphs in ISA 501:

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Table 1: Paragraph Re-numbering in ASA 502

Description	ISA 501	ASA 502	
	Para. #	Para. #	“Aus” Para. #
Requirements			
Litigation and Claims	9	4	
	10	5	Aus 5.1-Aus 5.2
	11	6	
	12	7	Aus 7.1-Aus 7.2
Application and Other Explanatory Material			
Litigation and Claims	A17	A1	Aus A1.1
	A18	A2	Aus A2.1-Aus A2.2
	A19	A3	
	A20	A4	Aus A 4.1
	A21	A5	
	A22	A6	
	A23	A7	Aus A7.1-Aus A7.2
	A24	A8	Aus A8.1-Aus A8.13
	A25	A9	Aus A9.1-Aus A9.3
	Footnote 10	*	
	Footnote 11	*	

[Aus] Appendix 1

(Ref: Para. 5 and A7)

This example letter relates to specific enquiry directed to the entity's external legal counsel, but may be adapted, as appropriate, to specific enquiry directed to the entity's internal legal counsel.

Example of a Letter of Specific Enquiry to External Legal Counsel (For an Audit Client)

(Client Letterhead)

(Date)

(Name and Address of External Legal Counsel)

Dear ...

In connection with the preparation and audit of the financial report of (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)
--	---	--

- 2 Should you disagree with any of the information included in 1 above, please comment on the nature of your disagreement.

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- 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.

It is understood that:

- (a) the company (and the above-named subsidiaries and/or divisions) may have used other legal counsel in certain matters;
- (b) the information sought relates only to information relating to litigation and claims 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 legal counsel 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.

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

Yours faithfully,

(Signature and Title of client)

SUPERSEDED