

Proposed SAAPS 4 (Revised 2019)

March 2019

Comments due:14 June 2019



South African Auditing Practice Statement

Letters of Specific Inquiry to the Entity's External Legal Practitioner Regarding Litigation and Claims Involving the Entity

WARNING TO READERS

The content of this proposed SAAPS 4 (Revised 2019) should, under no circumstances, be used or relied upon until it is issued as a pronouncement by the IRBA.

REQUEST FOR COMMENTS

The Independent Regulatory Board for Auditors' (IRBA) Committee for Auditing Standards (CFAS) approved this proposed South African Auditing Practice Statement (SAAPS) 4 (Revised 2019), *Letters of Specific Inquiry to the Entity's External Legal Practitioner Regarding Litigation and Claims Involving the Entity* (proposed SAAPS), in March 2019 for exposure for a period of 90 days for comment. This proposed SAAPS may be modified, in light of comments received, before being issued in its final form.

This proposed SAAPS has been prepared by a CFAS Task Group comprising technical staff representatives from auditing firms, as well as representatives of the legal profession and the South African Institute of Chartered Accountants.

The IRBA's Legislative Mandate

The objects of the Auditing Profession Act, 2005 (Act No. 26 of 2005) (APA), as set out in Section 2, are, inter alia:

- (c) *“to approve the development and maintenance of internationally comparable ethical standards and auditing standards for auditors that promote investment and as a consequence employment in the Republic; and*
- (d) *to set out measures to advance the implementation of appropriate standards of competence and good ethics in the auditing profession”.*

To give effect to the objects, Section 4 of the APA sets out the general functions of the Regulatory Board (the IRBA), and those include that *“the Regulatory Board must, in addition to its other functions provided for in this Act”*, take steps to meet certain specific requirements. These include Section 4(1), which specifies that the IRBA must:

- (c) *“prescribe standards of professional competence, ethics and conduct of registered auditors”;* and
- (e) *“prescribe auditing standards”.*

To enable the IRBA to meet these requirements, Section 4(2)(a) states that *“the Regulatory Board may participate in the activities of international bodies whose main purpose is to develop and set auditing standards and to promote the auditing profession”.*

Statutory Responsibilities of the CFAS

The statutory responsibilities of the CFAS are set out in Section 22(2), which requires that *“the CFAS must assist the Regulatory Board:*

- (a) *to develop, maintain, adopt, issue or prescribe auditing pronouncements;*
- (b) *to consider relevant international changes by monitoring developments by other auditing standard-setting bodies and sharing information where requested; and*
- (c) *to promote and ensure the relevance of auditing pronouncements”.*

This proposed SAAPS may be downloaded for free from the [IRBA website](#).

Comments should be submitted by 14 June 2019.

Respondents are requested to submit their comments electronically in Word and PDF formats to standards@irba.co.za. All comments will be considered as a matter of public record and will be posted on the [IRBA website](#).

REQUEST FOR COMMENTS

Should you have any queries, or experience any technical difficulties with downloading the document, please email the Standards Department at standards@irba.co.za .

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SECTION 1: INTRODUCTION

This memorandum provides the background to, and an explanation regarding, the proposed South African Auditing Practice Statement (SAAPS) 4, *Letters of Specific Inquiry to the Entity's External Legal Practitioner Regarding Litigation and Claims Involving the Entity* (Revised 2019) (proposed SAAPS).

International Standard on Auditing (ISA) 501, *Audit Evidence – Specific Considerations for Selected Items* (ISA 501), paragraph 10, states that: “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, in addition to the procedures required by other ISAs, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry, 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.”

ISA 501, application and other explanatory material paragraph A23, states that: “If it is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general inquiry, 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. For this purpose, a letter of specific inquiry 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.”

The proposed SAAPS contains an illustrative letter of specific inquiry.

The Committee for Auditing Standards (CFAS) approved this proposed SAAPS in March 2019 for exposure for a period of 90 days.

Background

On 1 January 2005 the then Auditing and Assurance Standards Board (AASB) adopted the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants for use in South Africa.

Prior to that, South African Auditing Standard (SAAS) 502, *Enquiries regarding litigation and claims*, issued in December 2002, had been developed locally for auditors when making inquiries regarding litigation and claims. SAAS 502 was reissued as a South African Auditing Practice Statement as the AASB was of the view that it contained necessary guidance for auditors in South Africa. The content of the extant SAAPS 4, *Enquiries relating to litigation and claims*, was taken directly from SAAS 502.

In October 2005, SAAS 502, *Enquiries regarding litigation and claims*, was withdrawn with the issue of the extant SAAPS 4.

SAAS 502 included an example of a request for an attorney's representation letter regarding litigation and claims, the text of which was agreed to by the AASB and the South African Institute of Chartered Accountants' (SAICA) Joint Attorneys and Accountants Committee. An agreement was reached on

the procedure to be followed when attorneys' representation letters are sought. The attorney profession was then notified of the procedure.

The extant SAAPS 4 requires revision in order to align it with amendments made to the ISAs subsequent to its issue in October 2005. Specifically, the content of extant SAAPS 4 needs consideration in the context of amendments to ISA 501, which became effective for audits of financial statements for periods beginning on or after 15 December 2009.

Project Timetable

Subject to comments received on exposure of this proposed SAAPS, the CFAS intends to finalise this SAAPS in the third quarter of 2019.

Effective Date

Depending on the comments received, the expectation is that the final SAAPS may be approved and issued by the CFAS in September 2019, with such approval and issue being noted at the subsequent meeting of the IRBA Board.

It is expected that this proposed SAAPS will be effective for letters of specific inquiry requested on or after 1 September 2019.

SECTION 2: GUIDE FOR RESPONDENTS

The CFAS welcomes comments on all matters addressed in this exposure draft, especially those identified in the Request for Specific Comments section (Section 4) below. Comments are most helpful when they refer to specific paragraphs, include the reason for the comments and, where appropriate, make specific suggestions for any proposed changes to the wording. When a respondent agrees with the proposals in the exposure draft, it will be helpful for the CFAS to be made aware of this view as this cannot always be inferred when not stated.

SECTION 3: SIGNIFICANT MATTERS

The matters set out under the heading "Section 4: Request for Specific Comments" have been discussed by the CFAS. Specific comments on these matters are requested from respondents.

Change in the Scope of the SAAPS

A review of the extant SAAPS indicated that its guidance was already contained in ISA 501. As such, most of the content of extant SAAPS 4 has been removed in this proposed SAAPS. The review of the extant SAAPS 4, however, highlighted the need for an illustrative letter of specific inquiry to an entity's external legal practitioner, where such communication is sought by the auditor. The illustrative letter in extant SAAPS 4, though, needed to be aligned to the requirements and application and other explanatory material in ISA 501.

Therefore, this proposed SAAPS contains a revised illustrative letter of specific inquiry to an entity's legal practitioner regarding litigation and claims involving the entity. In order to reflect the South African legal environment, and for the purposes of the proposed SAAPS, the ISA 501 term "external legal counsel" is referred to as "external legal practitioner". This is explained in paragraph 8 of the proposed SAAPS.

EXPLANATORY MEMORANDUM

This proposed SAAPS also includes a change in its name from *Enquiries Regarding Litigation and Claims* to the more appropriate *Letters of Specific Inquiry to the Entity's External Legal Practitioner Regarding Litigation and Claims*.

SECTION 4: REQUEST FOR SPECIFIC COMMENTS

Respondents are asked to comment on the clarity, understandability and practicality of the application of the guidance in the exposure draft. In this regard, comments will be most helpful if they are identified with specific aspects of the exposure draft and include reasons for any concern about clarity, understandability and practicality of application, along with suggested improvements. The CFAS is seeking comments on the following specific matters:

1. Are there any matters of principle regarding direct communication with the entity's external legal practitioner through a letter of specific inquiry, not already covered by ISA 501, that you believe should be addressed in this SAAPS?
2. If you have experienced practical difficulties regarding the illustrative attorney's representation letter that is contained in extant SAAPS 4, have those difficulties been addressed in the revised letter of specific inquiry in proposed SAAPS 4? If not, what changes would you propose to the illustrative letter?
3. Do you agree with the recommended effective date?

PROPOSED SAAPS 4 (REVISED 2019), LETTERS OF SPECIFIC INQUIRY TO THE ENTITY'S
EXTERNAL LEGAL PRACTITIONER REGARDING LITIGATION AND CLAIMS INVOLVING THE ENTITY

(Effective for letters of specific inquiry requested on or after 1 September 2019)

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This South African Auditing Practice Statement (SAAPS) is aimed at providing practical guidance to registered auditors when the auditor seeks direct communication with an entity's external legal practitioner through a letter of specific inquiry regarding litigation and claims involving the entity. This practice statement contains an illustrative letter of specific inquiry that has been developed in conjunction with representatives of the legal profession in South Africa.

South African Practice Statements are developed and issued by the IRBA to provide practical assistance to auditors in the implementation of relevant International or South African Standards on Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements. South African Practice Statements do not impose requirements on auditors beyond those included in the International or South African Standards or South African regulatory requirements; and they do not change the auditor's responsibility to comply, in all material respects, with the requirements of the International or South African Standards or with South African regulatory requirements relevant to the audit, review, other assurance or related services engagement.

An auditor is required to have an understanding of the entire text of every South African Practice Statement to enable the auditor to assess whether or not any particular South African Practice Statement is relevant to an engagement; and if so, to enable the auditor to properly apply the requirements of the particular International or South African Standard/s to which the South African Practice Statement relates.

In terms of Section 1 of the Auditing Profession Act, 2005 (Act No. 26 of 2005) (APA), a South African Practice Statement is included in the definition of "auditing pronouncements"; and in terms of the Act, the auditor must, in the performance of an audit, comply with those standards, practice statements, guidelines and circulars developed, adopted, issued or prescribed by the Regulatory Board.

Introduction

Scope

1. International Standard on Auditing (ISA) 501, *Audit Evidence – Specific Considerations for Selected Items* (ISA 501), paragraph 10, states that: “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, in addition to the procedures required by other ISAs, seek direct communication with the entity’s external legal counsel. The auditor shall do so through a letter of inquiry, 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.”

ISA 501, application and other explanatory material paragraph A23, states that: “If it is considered unlikely that the entity’s external legal counsel will respond appropriately to a letter of general inquiry, 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. For this purpose, a letter of specific inquiry 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.”
2. The ISA dealt with in this SAAPS is ISA 501 (Revised), *Audit Evidence – Additional Considerations for Specific Items* (ISA 501).
 3. This South African Auditing Practice Statement (SAAPS) contains an illustrative letter of specific inquiry to assist registered auditors in achieving the objective of ISA 501.
 4. The illustrative letter of specific inquiry to the entity’s external legal practitioner contained in this SAAPS:
 - Does not provide a substitute for the auditor’s responsibility to comply with ISA 501 and other relevant ISAs.
 - Does not establish new requirements or contain exemptions from the requirements of the ISAs; and should be read with the ISAs, as applicable.
 5. This SAAPS does not provide guidance on the application of the International Standards on Review Engagements (ISREs), the International Standards on Assurance Engagements (ISAEs) and the International Standards on Related Services (ISRSs). It may, nevertheless, be taken into account by a practitioner when considering the appropriate method of specific inquiry to the entity’s external legal practitioner regarding litigation and claims involving the entity.

6. Revisions to the International Auditing and Assurance Standards Board's Engagement Standards, the IRBA Code of Professional Conduct, the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (as applicable to Professional Accountants in Public Practice) and changes to South African legal and regulatory requirements may result in changes to the auditor's responsibility in relation to inquiries regarding litigations and claims. Therefore, users of this SAAPS must at all times apply the most up-to-date pronouncements and legislation in their use of this SAAPS.
7. The guidance contained in this practice statement also applies to the audit of financial statements in the public sector.

Terms Used in this SAAPS

8. For the purpose of this SAAPS, the following term has the meaning attributed below:

External legal practitioner: An entity's "legal practitioner" as defined in the Legal Practice Act, 2014 (Act No. 28 of 2014)¹. A "legal practitioner" refers to either an attorney or an advocate. It is intended to be equivalent to the ISA 501 term "external legal counsel".

The term "legal counsel" is not defined in South African legislation. It has been customary in South Africa to refer to an advocate as "counsel" in a representative form. Thus, reference to "external legal counsel" in a registered auditor's letter of specific inquiry may be misunderstood by the entity's legal practitioner. This SAAPS uses terminology which is appropriate in the South African environment.

Effective Date

9. This SAAPS is effective for letters of specific inquiry requested on or after 1 September 2019.

¹ Sections 1 and 34(2)(a)(ii).

Annexure – Illustrative Letter of Specific Inquiry to the Entity's External Legal Practitioner regarding Litigation and Claims Involving the Entity

[Letterhead of Client]

[Date]

[Name and Address of the External Legal Practitioner]

Dear [XX]

This letter has been prepared at the request of our auditor.

In accordance with the International Standards on Auditing, an auditor is required to seek direct communication with their audit client's external legal counsel (referred to as the "external legal practitioner" in the South African context) when the auditor has assessed a risk of material misstatement to the audit client's financial statements regarding identified litigation or claims involving the audit client, or when the audit procedures that were performed indicate that other material litigation or claims may exist.

In connection with the preparation and audit of the financial statements of [*insert name of entity*] (the entity) (and the subsidiaries), as indicated in the attached schedule for the reporting period ended (date), we request that you provide our auditor [*insert name of auditor*] (the auditor) at [*insert address*], by [*insert date*], with the following information regarding any existing or potential litigation and claims involving the entity, or the identified subsidiaries, of which you are aware:

- 1 Confirmation that you are representing the entity (and/or the abovementioned subsidiaries) in relation to the matters set out in the attached schedule.
- 2 Confirmation of the reasonableness of management's assessment, where available, of the outcome of each of the identified litigation and claims and management's estimate of the financial implications, including costs involved.
- 3 Should you consider any of the information included in the attached schedule to be incorrect, please provide the auditor with further information.
- 4 In addition to the above, we request that you bring to the attention of our auditor further litigation and claims, to which you are privy, that relate to the entity (and/or the abovementioned subsidiaries) and are not dealt with in the attached schedule.
- 5 In considering litigation and claims to be brought to the attention of our auditors, litigation and claims not exceeding R..... [*insert the amount that needs to be determined by the registered auditor*] are not considered material and need not be considered, unless you are aware of actions of a class that in aggregate may exceed the aforementioned amount.
- 6 With regard to the matters identified above, you are duly authorised to discuss these matters with our auditor, should the need arise.

It is thus understood that:

- (a) The entity (and the abovementioned subsidiaries) may have used external legal practitioners other than yourselves in certain matters that might have a direct and or an indirect impact on the entity (and/or the abovementioned subsidiaries) and the period under review.

- (b) The information sought hereafter relates only to existing and potential litigation and claims referred to your firm that were current at any time during the abovementioned reporting period; and those that have arisen since the end of the reporting period and including the ones up to the date of your response, which response is to be provided by the date as indicated above, bearing in mind that the expected date of signing the audit report is [*insert expected date of audit report*] and a response is required before this date.
- (c) Unless separately requested in writing, you are not responsible for keeping the auditor informed of any changes with regard to the matter/s at hand post the response date.
- (d) You are not required to respond on those matters within your knowledge solely because of the holding of any office as director, secretary or otherwise of the entity (and the abovementioned subsidiaries), or known through a consultant, partner or employee of your firm.
- (e) Your reply will be considered as legal advice and is sought for the information of, and assistance to, this entity and will not be quoted or otherwise referred to in any financial statements or related documents of the entity (and the abovementioned subsidiaries); 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.
- (f) All costs incurred by you in relation to the request will be for our account.

Your prompt assistance in this matter will be appreciated.

Kindly forward a signed copy of your reply to us for our records.

Yours faithfully,

.....<Signature of the client>

Schedule: Letter of Specific Inquiry to the Entity's External Legal Practitioner Regarding Litigation and Claims Involving the Entity

Name of entity (and/or subsidiaries):

Financial year-end:

Litigation and claims identified by the entity's management <i>(To be completed by the entity's management)</i>				External legal practitioner's confirmation and further comments, if applicable <i>(To be completed by the entity's external legal practitioner)</i>	
Name of entity (and/or subsidiary)	Management's description of the matter (including current status and the external legal practitioner's reference, if known).	Management's assessment of the possible outcome of each of the identified litigation and claims, where available.	Management's estimate of the financial implications (including costs and disbursements), where available.	External legal practitioner's confirmation of the reasonableness of management's assessments of the possible outcome and estimate of the financial implications, including costs involved. Indicate whether "reasonable" or "unreasonable".	If the information in the schedule is considered by the external legal practitioner to be incorrect, please provide further information.

We confirm that we represent the entity (and/or the abovementioned subsidiaries) in relation to the matters set out in the abovementioned schedule. Furthermore, we include our opinion, as individually indicated in the schedule above, on the reasonableness of management's assessments of the outcome of each of the identified litigation and claims and management's estimate of the financial implications, including costs involved, where available.

In addition to the above matters, we bring to your attention the following litigation and claims exceeding R.....*[insert the amount as determined by the registered auditor as per point 4 of the letter]* of which we are aware in relation to the entity (and/or the abovementioned subsidiaries).

PROPOSED SAAPS 4 (REVISED 2019), LETTERS OF SPECIFIC INQUIRY TO THE ENTITY'S EXTERNAL LEGAL PRACTITIONER REGARDING LITIGATION AND CLAIMS INVOLVING THE ENTITY

Litigation and claims not identified by the entity's management			
<i>(To be completed by the entity's external legal practitioner, if applicable)</i>			
Name of entity (and/or subsidiary)	External legal practitioner's description of the matter (including current status and external legal practitioner's reference).	External legal practitioner's assessment of the possible outcome of each of the identified litigation and claims, where available.	External legal practitioner's estimate of the financial implications (including costs and disbursements), where available.

OR

Management of the abovementioned entity (and the subsidiaries) has advised that there is no pending material litigation or any claims that have been referred to us as external legal practitioners that would involve financial implications (including costs and disbursements). We confirm that we are not currently representing the entity (or the abovementioned subsidiaries) in relation to litigation and claims involving the entity or subsidiaries.

External legal practitioner:

Name of law firm:

Date: