

AU Section 9337

Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments: Auditing Interpretations of Section 337

1. Specifying Relevant Date in an Audit Inquiry Letter

.01 Question—Should the auditor request the client to specify, in his audit inquiry letter to a lawyer prepared in accordance with section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, the date by which the lawyer's response should be sent to the auditor. Also, should the letter request the lawyer to specify in his response the latest date covered by his review (the "effective date")?

.02 Interpretation—Yes. It should be recognized that, to adequately respond to an audit inquiry letter, lawyers will ordinarily employ some internal review procedures which will be facilitated by specifying the earliest acceptable effective date of the response and the latest date by which it should be sent to the auditor. Ordinarily, a two-week period should be allowed between the specified effective date of the lawyer's response and the latest date by which the response should be sent to the auditor. Clearly stating the relevant dates in the letter and specifying these dates to the lawyer in a timely manner will allow the responding lawyer an adequate amount of time to complete his review procedures and assist the auditor in coordinating the timing of the completion of his field work with the latest date covered by the lawyer's review.

.03 Further, the lawyer should be requested to specify the effective date of his response. If the lawyer's response does not specify an effective date, the auditor can assume that the date of the lawyer's response is the effective date.

[Issue Date: March 1977.]

2. Relationship Between Date of Lawyer's Response and Auditor's Report

.04 Question—The illustrative form of audit inquiry letter included in the appendix [section 337A] to section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, requests a response as to matters that existed at the balance sheet date and during the period from that date to the date of the response. What is the relationship between the effective date of the lawyer's response and the date of the auditor's report, which is generally the date of the completion of field work?

.05 Interpretation—Section 560 paragraphs .10–.12 indicate that the auditor is concerned with events, which may require adjustments to, or disclosure in, the financial statements, occurring through the date of his or her report. Therefore, the latest date of the period covered by the lawyer's response (the "effective date") should be as close to the date of the auditor's report as is practicable in the circumstances. Consequently, specifying the effective date of the

lawyer's response to reasonably approximate the expected date of the auditor's report will in most instances obviate the need for an updated response from the lawyer.

[Issue Date: March 1977; Revised: December 2005.]

3. Form of Audit Inquiry Letter When Client Represents That No Unasserted Claims and Assessments Exist

.06 Question—The illustrative audit inquiry letter included in the appendix [section 337A] to section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, assumes that the client specifies certain unasserted claims and assessments. However, in some cases, clients have stated that there are no such claims or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome. What appropriate revision to the wording of the letter can be used in such situations?

.07 Interpretation—Wording that could be used in an audit inquiry letter, instead of the heading and first paragraph in the section relating to unasserted claims and assessments included in the appendix [section 337A] to section 337, when the client believes that there are no unasserted claims or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, is as follows:

Unasserted claims and assessments—We have represented to our auditors that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. (The second paragraph in the section relating to unasserted claims and assessments would not be altered.)

[Issue Date: March 1977; Revised: June 2009.]

4. Documents Subject to Lawyer-Client Privilege

.08 Question—Section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, paragraph .05c, states: "Examine documents in the client's possession concerning litigation, claims, and assessments, including correspondence and invoices from lawyers." Would this include a review of documents at the client's location considered by the lawyer and the client to be subject to the lawyer-client privilege?

.09 Interpretation—No. Although ordinarily an auditor would consider the inability to review information that could have a significant bearing on his audit as a scope restriction, in recognition of the public interest in protecting the confidentiality of lawyer-client communications (see section 337 paragraph .13), section 337 paragraph .05(c) is not intended to require an auditor to examine documents that the client identifies as subject to the lawyer-client privilege. In the event of questions concerning the applicability of this privilege, the auditor may request confirmation from the client's counsel that the information is subject to that privilege and that the information was considered by the lawyer in

responding to the audit inquiry letter or, if the matters are being handled by another lawyer, an identification of such lawyer for the purpose of sending him an audit inquiry letter.

[Issue Date: March 1977.]

5. Alternative Wording of the Illustrative Audit Inquiry Letter to a Client's Lawyer

.10 Question—The appendix [section 337A] of section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, provides an illustrative audit inquiry letter to legal counsel. That inquiry letter is based on the assumptions that (1) management of the company has prepared and furnished to the auditor and has set forth in the audit inquiry letter a description and evaluation of pending or threatened litigation, claims, and assessments and (2) management has identified and specified for comment in the audit inquiry letter unasserted claims or assessments that are probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome. In many engagements, circumstances may render certain portions of the illustrative letter inappropriate. For instance, many clients ask their lawyers to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments rather than have management furnish such information. How can the wording of the inquiry letter be modified to recognize circumstances that differ from those assumed in the illustrative letter and to be more specific regarding the timing of the lawyer's response?

.11 Interpretation—Section 337 paragraph .09, outlines the matters that should be covered in a letter of audit inquiry. Although section 337 provides an illustrative audit inquiry letter to legal counsel, it should be modified, if necessary, to fit the circumstances. The modified illustrative audit inquiry letter that follows is based on a typical situation: management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments, and also represents that there are no unasserted claims or assessments that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*. It also includes a separate response section with language that clarifies the auditor's expectations regarding the timing of the lawyer's response.

"In connection with an audit of our financial statements as of (balance-sheet date) and for the (period) then ended, please furnish our auditors, (name and address of auditors), with the information requested below concerning certain contingencies involving matters with respect to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation." [When a materiality limit has been established based on an understanding between management and the auditor, the following sentence should be added: This request is limited to contingencies amounting to (amount) individually or items involving lesser amounts that exceed (amount) in the aggregate.]

.12 Pending or Threatened Litigation, Claims, and Assessments

"Regarding pending or threatened litigation, claims, and assessments, please include in your response: (1) the nature of each matter, (2) the progress of each matter to date, (3) how the Company is responding or intends to respond

(for example, to contest the case vigorously or seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss."

.13 Unasserted Claims and Assessments

"We have represented to our auditors that there are no unasserted possible claims or assessments that you have advised us are probable of assertion and must be disclosed in accordance with FASB ASC 450.¹ We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of FASB ASC 450. Please specifically confirm to our auditors that our understanding is correct."

.14 Response

"Your response should include matters that existed as of (balance-sheet date) and during the period from that date to the effective date of your response."

"Please specifically identify the nature of and reasons for any limitations on your response."

"Our auditors expect to have the audit completed about (expected completion date). They would appreciate receiving your reply by that date with a specified effective date no earlier than (ordinarily two weeks before expected completion date)."²

[Issue Date: June 1983; Revised: June 2009.]

6. Client Has Not Consulted a Lawyer

.15 Question—Section 337 paragraph .06 requires an auditor to request that the client's management send a letter of inquiry to those lawyers with whom management has consulted concerning litigation, claims, or assessments. In some instances, management may not have consulted a lawyer. In such circumstances, what should the auditor do to obtain sufficient, appropriate audit evidence regarding litigation, claims, and assessments?

.16 Interpretation—Section 337 is expressly limited to inquiry of lawyers with whom management has consulted. If the client has not consulted a lawyer, the auditor normally would rely on the review of internally available information as outlined in section 337 paragraph .05 and .07, and the written

¹ A parenthetical statement such as "(excerpts of which can be found in the ABA's *Auditor's Letter Handbook*)" might be added here if the auditor believes that it would be helpful to the lawyer's understanding of the requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*. The *Auditor's Letter Handbook* contains, among other things, a copy of section 337, the ABA's *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (section 337C), and excerpts from FASB ASC 450. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

² Two auditing interpretations (see Interpretation Nos. 1–2 of section 337 [par. .01–.05]) address relevant dates in an audit inquiry letter and the relationship between the date of the lawyer's response and the audit report date.

representation of management regarding litigation, claims, and assessments as required by section 333, *Management Representations*, paragraph .06o and p. In those circumstances, the representation regarding litigation, claims, and assessments might be worded as follows:

We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

.17 If information comes to the auditor's attention that may indicate potentially material litigation, claims, and assessments, the auditor should discuss with the client its possible need to consult legal counsel so that the client may evaluate its responsibility under Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies* to accrue or disclose loss contingencies. Depending on the severity of the matter, refusal by the client to consult legal counsel in those circumstances may result in a scope limitation, and the auditor should consider the effect of such a limitation on his audit report.

[Issue Date: June 1983; Revised: January 2004; Revised: March 2006; Revised: June 2009.]

7. Assessment of a Lawyer's Evaluation of the Outcome of Litigation

.18 *Question*—Section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, paragraph .09d(2), states that a letter of audit inquiry should include a request for the lawyer's evaluation of the likelihood of an unfavorable outcome of pending or threatened litigation, claims, and assessments to which he has devoted substantive attention. However, written responses from lawyers vary considerably and may contain evaluation wording that is vague or ambiguous and, thus, of limited use to the auditor. What constitutes a clear response and what should the auditor do if he considers the response unclear?

.19 *Interpretation*—The American Bar Association's *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (ABA Statement) is reprinted as exhibit II [section 337C] to section 337. While paragraph 5 of the ABA statement [section 337C] states that the lawyer "may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is 'probable' or 'remote'," he is not required to use those terms in communicating his evaluation to the auditor. The auditor may find other wording sufficiently clear as long as the terms can be used to classify the outcome of the uncertainty under one of the three probability classifications established in Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*.³

.20 Some examples of evaluations concerning litigation that may be considered to provide sufficient clarity that the likelihood of an unfavorable outcome is "remote" even though they do not use that term are:

- "We are of the opinion that this action will not result in any liability to the company."

³ Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, uses the terms *probable*, *reasonably possible*, and *remote* to describe different degrees of likelihood that future events will confirm a loss or an impairment of an asset or incurrence of a liability, and the accounting standards for accrual and disclosure are based on those terms. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

- "It is our opinion that the possible liability to the company in this proceeding is nominal in amount."
- "We believe the company will be able to defend this action successfully."
- "We believe that the plaintiff's case against the company is without merit."
- "Based on the facts known to us, after a full investigation, it is our opinion that no liability will be established against the company in these suits."

.21 Absent any contradictory information obtained by the auditor either in other parts of the lawyer's letter or otherwise, the auditor need not obtain further clarification of evaluations such as the foregoing.

.22 Because of inherent uncertainties described in section 337 paragraph .14 and in the ABA Policy Statement [section 337C], an evaluation furnished by the lawyer may indicate significant uncertainties or stipulations as to whether the client will prevail. The following are examples of lawyers' evaluations that are unclear as to the likelihood of an unfavorable outcome:

- "This action involves unique characteristics wherein authoritative legal precedents do not seem to exist. We believe that the plaintiff will have serious problems establishing the company's liability under the act; nevertheless, if the plaintiff is successful, the award may be substantial."
- "It is our opinion that the company will be able to assert meritorious defenses to this action." (The term "meritorious defenses" indicates that the company's defenses will not be summarily dismissed by the court; it does not necessarily indicate counsel's opinion that the company will prevail.)
- "We believe the action can be settled for less than the damages claimed."
- "We are unable to express an opinion as to the merits of the litigation at this time. The company believes there is absolutely no merit to the litigation." (If client's counsel, with the benefit of all relevant information, is unable to conclude that the likelihood of an unfavorable outcome is "remote," it is unlikely that management would be able to form a judgment to that effect.)
- "In our opinion, the company has a substantial chance of prevailing in this action." (A "substantial chance," a "reasonable opportunity," and similar terms indicate more uncertainty than an opinion that the company will prevail.)

.23 If the auditor is uncertain as to the meaning of the lawyer's evaluation, he should request clarification either in a follow-up letter or a conference with the lawyer and client, appropriately documented. If the lawyer is still unable to give an unequivocal evaluation of the likelihood of an unfavorable outcome in writing or orally, the auditor should look to the guidance in section 508 paragraphs .45–.49 to determine the effect, if any, of the lawyer's response on the auditor's report.

[Issue Date: June 1983; Revised: February 1997; Revised: June 2009.]

8. Use of the Client's Inside Counsel in the Evaluation of Litigation, Claims, and Assessments

.24 Question—Section 337 paragraph .06 requires an auditor to request that the client's management send a letter of inquiry to those lawyers with whom management has consulted concerning litigation, claims, and assessments. Sometimes, the client's inside general counsel or legal department (hereinafter referred to as "inside counsel") is handling litigation, claims, and assessments either exclusive of or in conjunction with outside lawyers. In such circumstances, when does inside counsel's response constitute sufficient, appropriate audit evidence regarding litigation, claims, and assessments?

.25 Interpretation—Section 337 paragraph .08 states that "Audit evidence obtained from the client's inside general counsel or legal department may provide the auditor with the necessary corroboration." Inside counsel can range from one lawyer to a large staff, with responsibilities ranging from specific internal matters to a comprehensive coverage of all of the client's legal needs, including litigation with outside parties. Because both inside counsel and outside lawyers are bound by the ABA's Code of Professional Responsibilities, there is no difference in their professional obligations and responsibilities. In some circumstances, outside lawyers, if used at all, may be used only for limited purposes, such as data accumulation or account collection activity. In such circumstances, inside counsel has the primary responsibility for corporate legal matters and is in the best position to know and precisely describe the status of all litigation, claims, and assessments or to corroborate information furnished by management.

.26 Audit inquiry letters should be sent to those lawyers, which may be either inside counsel or outside lawyers, who have the primary responsibility for, and knowledge about, particular litigation, claims, and assessments. If inside counsel in handling litigation, claims, and assessments exclusively, their evaluation and response ordinarily would be considered adequate. Similarly, if both inside counsel and outside lawyers have been involved in the matters, but inside counsel has assumed the primary responsibility for the matters, inside counsel's evaluation may well be considered adequate.⁴ However, there may be circumstances when litigation, claims, or assessments involving substantial overall participation by outside lawyers are of such significance to the financial statements that the auditor should consider obtaining the outside lawyers' response that they have not formulated a substantive conclusion that differs in any material respect from inside counsel's evaluation, even though inside counsel may have primary responsibility.

.27 If both inside counsel and outside lawyers have devoted substantive attention to a legal matter, but their evaluations of the possible outcome differ, the auditor should discuss the differences with the parties involved. Failure to reach agreement between the lawyers may require the auditor to consider appropriate modification of his audit report.

[Issue Date: June 1983; Revised: March 2006.]

9. Use of Explanatory Language About the Attorney-Client Privilege or the Attorney Work-Product Privilege

.28 Question—In some cases, in order to emphasize the preservation of the attorney-client privilege or the attorney work-product privilege, some clients

⁴ This does not alter the caveat in section 337 paragraph .08 that "evidential matter obtained from inside counsel is not a substitute for information outside counsel refuses to furnish."

have included the following or substantially similar language in the audit inquiry letter to legal counsel:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

For the same reason, some lawyers have included the following or substantially similar language in their response letters to auditors:

The Company [OR OTHER DEFINED TERM] has advised us that, by making the request set forth in its letter to us, the Company [OR OTHER DEFINED TERM] does not intend to waive the attorney-client privilege with respect to any information which the Company [OR OTHER DEFINED TERM] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [OR OTHER DEFINED TERM].

Does the explanatory language about the attorney-client privilege or the attorney work-product privilege result in a limitation on the scope of the audit?

.29 Answer—No. According to the *Report by the American Bar Association's Subcommittee on Audit Inquiry Responses*, explanatory language similar to the foregoing in the letters of the client or the lawyer is not a limitation on the scope of the lawyer's response. The report states that such language simply makes explicit what has always been implicit, namely, the language states clearly that neither the client nor the lawyer intended a waiver. The report further states that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges. The *Report by the American Bar Association's Subcommittee on Audit Inquiry Responses* is reprinted in paragraph .30.

.30 Report of the Subcommittee on Audit Inquiry Responses*

Because of a recent court case and other judicial decisions involving lawyers' responses to auditors' requests for information, an area of uncertainty or concern has been brought to the Subcommittee's attention and is the subject of the following comment:

This Committee's report does not modify the ABA Statement of Policy, nor does it constitute an interpretation thereof. The Preamble to the ABA Statement of Policy states as follows:

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

* "Excerpted from 'Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information,' *The Business Lawyer*, vol. 31, no. 3, April 1976, copyright 1976 American Bar Association, reprinted by permission of the American Bar Association."

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political, and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and to act in accordance with counsel's advice.

Paragraph (1) of the ABA Statement of Policy provides as follows:

(1) *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5,[†] promulgated by the Financial Accounting Standards Board in March 1975 and discussed in Paragraph 5.1 of the accompanying commentary), to the extent hereinafter set forth, subject to the following:

(a) Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.

(b) In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

(c) Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.

(d) In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

In order to preserve explicitly the evidentiary privileges, some lawyers have suggested that clients include language in the following or substantially similar form:

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification*[™] (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission. As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

If client's request letter does not contain language similar to that in the preceding paragraph, the lawyer's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the lawyer, in writing or orally, in other communications or in discussions.

For the same reason, the response letter from some lawyers also includes language in the following or substantially similar form:

The Company [OR OTHER DEFINED TERM] has advised us that, by making the request set forth in its letter to us, the Company [OR OTHER DEFINED TERM] does not intend to waive the attorney-client privilege with respect to any information which the Company [OR OTHER DEFINED TERM] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [OR OTHER DEFINED TERM].

We believe that language similar to the foregoing in letters of the client or the lawyer simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver. It follows that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges.

On the other hand, the inclusion of such language does not necessarily assure the client that, depending on the facts and circumstances, a waiver may not be found by a court of law to have occurred.

We do not believe that the foregoing types of inclusions cause a negative impact upon the public policy considerations described in the Preamble to the ABA Statement of Policy nor do they intrude upon the arrangements between the legal profession and the accounting profession contemplated by the ABA Statement of Policy. Moreover, we do not believe that such language interferes in any way with the standards and procedures of the accounting profession in the auditing process nor should it be construed as a limitation upon the lawyer's reply to the auditors. We have been informed that the Auditing Standards Board of the AICPA has adopted an interpretation of SAS 12 recognizing the propriety of these statements.

Lawyers, in any case, should be encouraged to have their draft letters to auditors reviewed and approved by the client before releasing them to the auditors and may wish to explain to the client the legal consequences of the client's consent to lawyer's response as contemplated by subparagraph 1(d) of the Statement of Policy.

December 1989

[Issue Date: February, 1990.]

10. Use of Explanatory Language Concerning Unasserted Possible Claims or Assessments in Lawyers' Responses to Audit Inquiry Letters

.31 Question—In order to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments, some lawyers include the following or substantially similar language in their responses to audit inquiry letters:

"Please be advised that pursuant to clauses (b) and (c) of Paragraph 5 of the ABA Statement of Policy [American Bar Association's *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*] and related Commentary referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the Company. We can only furnish information concerning those unasserted possible claims or assessments upon which the Company has specifically requested in writing that we comment. We also cannot comment upon the adequacy of the Company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same."

Does the inclusion of this or similar language result in a limitation on the scope of the audit?

.32 Interpretation—No. Additional language similar to the foregoing in a letter of a lawyer is not a limitation on the scope of the audit. However, the ABA Statement of Policy [section 337C] and the understanding between the legal and accounting professions assumes that the lawyer, under certain circumstances, will advise and consult with the client concerning the client's obligation to make financial statement disclosure with respect to unasserted possible claims or assessments.⁵ Confirmation of this understanding should be included in the lawyer's response.

[Issue Date: January 1997; Revised: June 2009.]

⁵ See paragraph 6 of the ABA Statement of Policy [section 337C] and its commentary [section 337C]. In addition, Annex A to the ABA Statement of Policy [section 337C] contains the following illustrative language in the lawyers' response letter to the auditors:

Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Company's request, this will confirm as correct the Company's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of FASB Statement No. 5, *Accounting for Contingencies*.

[See footnote †.] [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]