



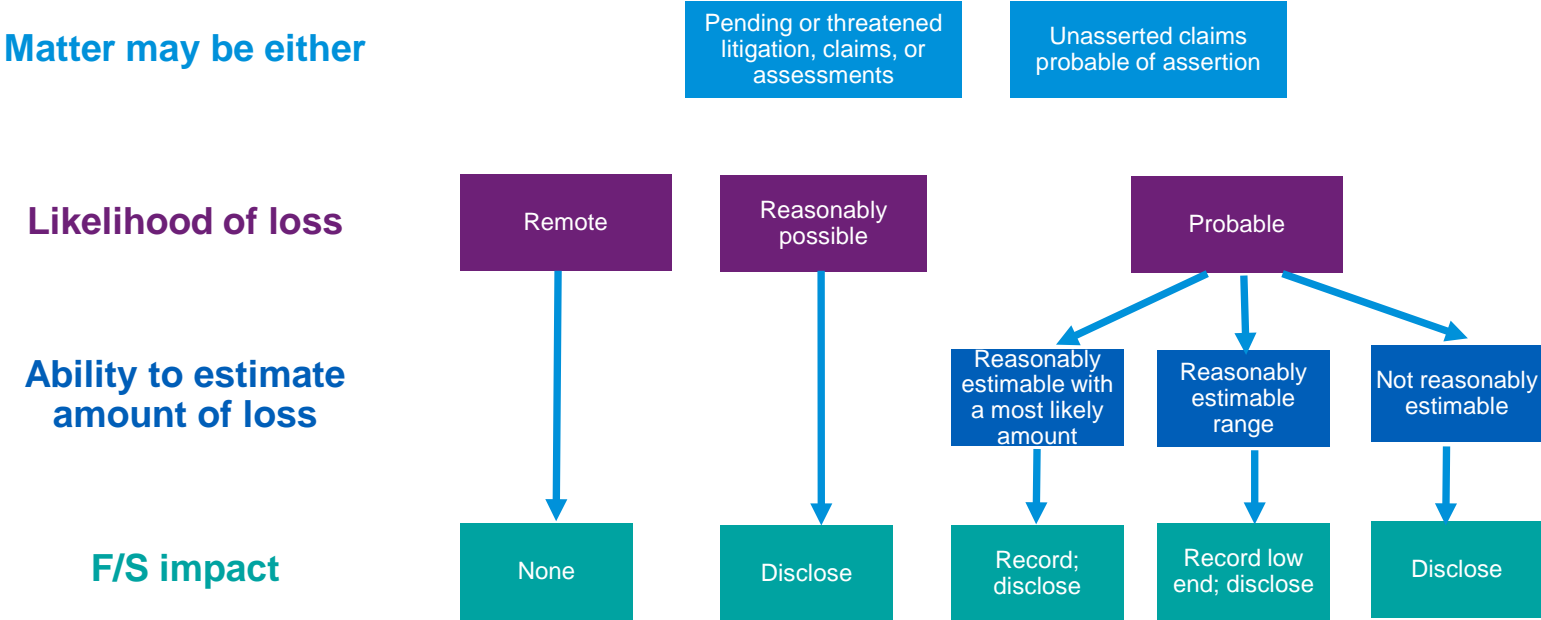
Audit legal letters

February 20, 2019



Financial statement impact

Company management is responsible to ensure their financial statements properly reflect litigation, claims, and assessments. Depending on the likelihood of loss, an amount may need to be recorded and/or the potential loss disclosed.



Source: ASC 450-20

Auditor requirements

The auditor should design and perform audit procedures to identify litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement.

Unless procedures indicate there are no actual or potential litigation, claims, or assessments that may give rise to a risk of material misstatement, the auditor should:

- seek direct communication with the entity's external legal counsel
- seek direct communication with the entity's in-house legal counsel, however, it is not a substitute for direct communication.

For actual or potential litigation, claims, and assessments, obtain audit evidence relevant to:

- The period in which the underlying cause for legal action occurred
- The degree of probability of an unfavorable outcome
- The amount or range of potential loss

Source: AU-C 501.16 - .24

What are auditors looking for?

Relevant matters include:

- Pending or threatened litigation, claims and assessments
- Unasserted claims considered probable of assertion

For each matter identified, management's or external counsel description should include:

- Description of the matter, progress of the case to date, intended action
- Evaluation of the likelihood of an unfavorable outcome
- Estimate of the amount or range of potential loss

It is preferable that the entity's legal counsel's response be as close to the date of the auditor's report as is practicable in the circumstances

Potential scope limitation

Potential scope limitation

- Legal counsel unable to respond concerning the likelihood of an unfavorable outcome because they are unable to form a conclusion
- Legal counsel refuses to furnish the requested information

Not a scope limitation

- Response limited to matters to which the legal counsel has given substantive attention in the form of legal consultation or representation.
- Response may be limited to matters that are considered individually or collectively material to the financial statements (amount given in confirmation request)
- Statements preserving attorney-client privilege when accompanied by appropriate information

If auditor cannot obtain sufficient audit evidence the financial statements are not materially misstated, the audit opinion must be modified

Challenges in the process

Management doesn't provide a list of litigation, claims, or assessments

- Counsel to provide list of matters of which they are aware

Letters replying “unable to state” likelihood of loss

- Potential scope limitation for the audit

Subsequent events

- If the event triggering a potential loss occurred prior to year end, use all information known through the audit report date to make the assessment

Timing – letters received too soon or too late

- No more than two weeks from date of letter to report date
- Verbal update is acceptable for auditors



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