

The ABA Statement on Audit Responses: A Framework that Has Stood the Test of Time

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This article summarizes key developments in the preparation of audit response letters concerning loss contingencies since the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information was published in 1976. These developments illustrate both the utility of the framework set forth in the ABA Statement and the responsiveness of the American Bar Association through the Business Law Section Audit Responses Committee (and predecessor committees) to issues arising under the ABA Statement and changes in accounting and auditing standards and practice. The ABA Statement, throughout its use, has served two important objectives: (i) to facilitate effective auditing as the underpinning for public confidence in financial reporting, and (ii) to preserve client confidences as mandated by attorney ethics rules and to protect attorney-client privilege, each of which is a critical component of our legal system. With these objectives in mind, the article highlights some challenges that the legal and accounting professions have navigated over the past forty-plus years, offering perspectives on the current framework that should serve as a resource to the legal and accounting professions going forward.

INTRODUCTION

Much has changed since the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (the "ABA Statement")¹ and the related American Institute of Certified Public Accountants

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1. *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976), reprinted in ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK I (2d ed. 2013) [hereinafter AUDITOR'S LETTER HANDBOOK]. The Statement had been approved in principle by the Section Council in Montreal in August 1975 and, as revised, in early December 1975.

Statement of Auditing Standards No. 12 (“SAS 12”)² were approved in December 1975 and January 1976, respectively. Those statements establish the framework for auditors to obtain information regarding legal claims against the company under audit. Under this framework, pursuant to SAS 12, the client of the auditor requests its attorney to provide information regarding such claims, and the attorney responds to that request in a letter following the guidance of the ABA Statement.

Since adoption of the ABA Statement and SAS 12 over forty years ago, we have seen an increased emphasis on the quality of loss contingency disclosure, an expansion of private litigation and SEC enforcement actions against accountants and other professionals, a new regulatory regime for the accounting profession established by the Sarbanes-Oxley Act of 2002, the development of new technologies to facilitate the audit letter process, and a substantial change in the standard auditor’s report to require disclosure of critical audit matters. Despite these changes, the ABA Statement has stood the test of time and shown its flexibility to adapt to meet changing circumstances. Indeed, as this article demonstrates, since publication of the ABA Statement over forty years ago, there have been relatively few formal statements about it by the American Bar Association (“ABA”) or its committees, and no substantive amendment to it.

The ABA Statement provides a framework designed to balance competing demands of the accounting and legal professions, specifically by (i) facilitating effective auditing as the underpinning for public confidence in financial reporting and (ii) preserving client-attorney confidentiality as mandated by attorney ethics rules and protecting attorney-client privilege. The latter objective is of paramount societal concern to all lawyers as a primary means to encourage client consultation with counsel. The former is of concern, not only as a matter of an auditor’s professional responsibility, but for reliable financial markets. Taken together, these objectives must be pursued flexibly by adjusting to changing business and regulatory demands regarding company financial reporting, and that flexibility should be available without requiring constant amendment or interpretation. Experience over the past forty-plus years demonstrates that this goal has been achieved.

The ABA Statement achieves these objectives by (i) requiring lawyers to identify to auditors pending and threatened claims they are handling, but permitting them to assess the likely outcome only when an adverse result is either “probable” or “remote” (as defined in the ABA Statement), (ii) limiting when lawyers may address unasserted claims, and (iii) having lawyers, when appropriate in connection with their engagement, acknowledge to auditors their professional

2. Codification of Statements on Auditing Standards, AU Section 337 n.1 (Am. Inst. Certified Pub. Accountants 1976) (clarified and recodified at Codification of Statements on Auditing Standards, AU-C Section 501 (Am. Inst. Certified Pub. Accountants 2013)); *see also* Auditing Standard, AS Section 2505 (Pub. Co. Accounting Oversight Bd. 2017). SAS 12 superseded the commentary, “Lawyers’ Letters,” AU Section 1001 (Am. Inst. Certified Pub. Accountants Jan. 1974), and AICPA Auditing Interpretations AU Section 9560.

responsibility with respect to client disclosures, thereby providing a basis for auditors to know whether lawyers who advise clients on disclosure matters meet such responsibility. These basic elements form the structure that governs an otherwise unregulated process involving potentially conflicting demands of the legal and accounting professions.

I. LOSS CONTINGENCIES UNDER FAS 5 (RECODIFIED UNDER FASB ASC SUBTOPIC 450-20)

The present audit response letter process can be traced back to adoption of the modern-day accounting standards for loss contingency disclosure. In March 1975, the Financial Accounting Standards Board (“FASB”) adopted Statement of Financial Accounting Standards (“FAS”) No. 5, *Accounting for Contingencies*, which was later recodified as FASB Accounting Standards Codification 450-20 (“ASC 450-20”).³ FAS 5 set forth consolidated guidance for accounting for contingencies, defining a contingency as “an existing condition, situation, or set of circumstances involving uncertainty as to possible gain . . . or loss . . . to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.”⁴ Notably, FAS 5 established new standards of financial accounting and reporting for loss contingencies. In this regard, FAS 5 focused on the likelihood that a future event will occur and defined three terms necessary for navigating that question:

- a. *Probable*. The future event or events are likely to occur.
- b. *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
- c. *Remote*. The chance of the future event or events occurring is slight.⁵

Among the examples of loss contingencies described in FAS 5 are “pending or threatened litigation” and “actual or possible claims and assessments,”⁶ which provide the basic lens through which companies consider their disclosure obligations and as to which auditors are seeking support, including from company lawyers.

3. Fin. Accounting Standards Bd., FASB Statement No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles (June 2009), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176156308762&acceptedDisclaimer=true.

4. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS No. 5, at 4 (Fin. Accounting Standards Bd. 1975), https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220126761&acceptedDisclaimer=true. As set forth in the standard, FAS 5 superseded prior contingency guidance in Accounting Research Bulletin (“ARB”) No. 50 and Chapter 5, “Contingency Reserves,” of ARB No. 43.

5. *Id.*

6. *Id.* at 5.

The basic rule under FAS 5 is that an estimated loss from a loss contingency must be accrued by a charge to income if *both* of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements . . . ; and
- b. The amount of loss can be reasonably estimated.⁷

If either of these conditions is not satisfied, or if an exposure to loss exists in excess of the amount accrued, then footnote disclosure of such conditions must be provided when “there is at least a reasonable possibility that a loss or an additional loss may have been incurred.”⁸ With regard to an unasserted claim or assessment, no disclosure or accrual need be provided “when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.”⁹

With the adoption of FAS 5 bringing loss contingency accounting into greater focus, guidance and procedures became necessary, in recognition that a client’s lawyers, not its auditors, are in the best position to assess legal matters giving rise to loss contingency accruals or disclosures in a client’s financial statements. In response to this need, in January 1976, the American Institute of Certified Public Accountants (“AICPA”) issued Statement on Auditing Standard 12, *Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments*.¹⁰

II. STATEMENT OF POLICY REGARDING LAWYERS’ RESPONSES TO AUDITORS’ REQUESTS FOR INFORMATION, AND RELATED COMMENTARY AND ILLUSTRATIVE FORMS OF RESPONSES

In response to the adoption of FAS 5 and concurrently with the adoption of SAS 12, the legal profession, through the ABA, engaged with the accounting profession, with prompting from the Securities and Exchange Commission, to reach an understanding that protected client confidences and the attorney-client privilege in connection with the provision by lawyers of information to auditors. In recognition of the need to establish a framework that would appropriately balance the “public interest in protecting the confidentiality of lawyer-client communications” with ensuring “public confidence in published financial statements,” the Board of Governors of the ABA on December 8, 1975, approved the ABA Statement.

The ABA Statement consists of eight paragraphs with accompanying Commentary to each of those paragraphs, which Commentary forms an “integral part” of

7. *Id.* at 5–6.

8. *Id.*

9. *Id.*

10. See *supra* note 2.

the ABA Statement.¹¹ Each of the eight paragraphs governs a key element of lawyers' responses, and all remain applicable today:

1. Client Consent to Response
2. Limitation on Scope of Response
3. Response May Be Limited to Material Terms
4. Limited Responses
5. Loss Contingencies
6. Lawyer's Professional Responsibility
7. Limitation on Use of Response
8. General

Though lawyers are not obligated to follow the approach set forth in the ABA Statement,¹² the ABA Statement has become the governing framework for attorneys preparing audit response letters, with lawyers commonly including a statement similar to the following in their audit response letters, as indicated in Paragraph 8 of the ABA Statement:

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement).¹³

A key contributor to the longevity of the ABA Statement is that its development was premised on the following basic ground rules¹⁴:

- A lawyer will only furnish information in an audit response letter with respect to "loss contingencies" as defined in FAS 5 that may result in incurrence of a liability or impairment of an asset if the lawyer has devoted substantive attention to and consulted with the client with respect to the following loss contingencies:
 - overtly threatened or pending litigation, whether or not specifically identified by the client;
 - contractually assumed obligations that the client has specifically identified and upon which the client has specifically requested comment to the auditor; and

11. ABA Statement, *supra* note 1, at 1715.

12. *Id.* at para. 8.

13. *Id.*

14. A similar description was set forth in *Statement on Effect of FIN 48 on Audit Response Letters*, 64 BUS. LAW. 389, 390–91 (2009), reprinted in AUDITOR'S LETTER HANDBOOK, *supra* note 1, at 59.

- o unasserted possible claims or assessments that the client has specifically identified and upon which the client has specifically requested comment to the auditor.
- A lawyer will not express any opinion in the audit response letter on the outcome or amount of exposure of a loss contingency or the extent of possible exposure unless the lawyer concludes that liability is either probable or remote.
- A lawyer should not be requested to comment on unasserted claims unless the client has determined that it is probable (i.e., “likely to occur”) that a possible claim will be asserted, that there is a reasonable possibility that, if asserted, the outcome will be unfavorable, and that a resulting liability will be material to the financial condition of the client.
- A lawyer should confirm, as contemplated by the ABA Statement, at Paragraph 6, that, when the lawyer, within the scope of the lawyer’s engagement, has formed a professional judgment that the client must disclose or consider disclosure of a possible claim in its financial statements, the lawyer will so advise the client and consult with the client regarding such disclosure. The auditor may assume that in these circumstances the lawyer has advised the client regarding disclosure of unasserted claims that may call for financial statement disclosure. If the lawyer’s advice regarding disclosure is disregarded by the client, the lawyer, as a matter of professional responsibility, may need to consider withdrawal from the engagement or other remedial action.

Also helpful in establishing the ABA Statement as the default framework were the illustrative forms of letters provided for use by an outside practitioner or law firm and by an inside general counsel that were attached as Annex A to the ABA Statement.¹⁵ These illustrative templates set forth a consistent response framework, creating efficiencies in the audit response letter process for both lawyers and the auditors receiving such letters. Many law firms have developed their own forms of audit response letters, which may deviate from the illustrative templates accompanying the ABA Statement, though the basic contents and general structure of the lawyers’ responses typically remain consistent with those envisioned by the ABA Statement.

III. EARLY IMPLEMENTATION GUIDANCE

A. FIRST REPORT OF THE COMMITTEE ON AUDIT INQUIRY RESPONSES

To assist lawyers with the initial implementation of the ABA Statement, the ABA Committee on Audit Inquiry Responses published a “First Report” in the

15. ABA Statement, *supra* note 1, at 1733–36.

same April 1976 issue of *The Business Lawyer* that included the ABA Statement.¹⁶ The First Report was neither an interpretation, nor intended to modify any aspect, of the ABA Statement. Primarily, the First Report sought to reconcile the AICPA's SAS 12, which was adopted on January 7, 1976, and the ABA Statement.

Among its various insights, the First Report contains an important professional responsibility reminder for all lawyers following the ABA Statement in responding to audit inquiry letters:

Because the ABA Statement will govern responses to auditors' inquiry letters of all lawyers who so elect—not just the responses of general counsel or lawyers advising with respect to securities law matters on an ongoing basis—every lawyer who follows the ABA Statement should familiarize himself with Paragraph 6 of the ABA Statement, which discusses the lawyer's professional responsibility to his client to advise the client, in the circumstances outlined in Paragraph 6, concerning disclosure requirements applicable to unasserted possible claims.¹⁷

This advice relates to a critical feature of the ABA Statement, which affords significant protection to the attorney-client privilege with respect to unasserted possible claims, while recognizing an obligation of lawyers to counsel their clients in the circumstances specified in Paragraph 6 of the ABA Statement. Consistent with lawyers' professional responsibilities, Paragraph 6 of the ABA Statement makes clear that a lawyer has “an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. The lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client.”¹⁸

The First Report also contains a number of practical tips for abiding by the ABA Statement. For instance, the First Report addresses lawyer obligations to obtain information for purposes of responding to audit inquiry letters and evaluating the outcomes of, and estimating losses regarding, matters included in the lawyer's audit response letter. The First Report also includes an illustrative form of audit inquiry letter drawn from SAS 12, thus rounding out the set of illustrative letters for lawyers and auditors.¹⁹ This illustrative form of audit inquiry letter, like the illustrative form of audit response letter attached to the ABA Statement, has served as a key foundational document in implementing, on a day-to-day basis, the audit inquiry and response process, though audit firms have sometimes made tweaks to the audit inquiry letter over the years.²⁰

16. *Introductory Analysis and Guides to Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 *BUS. LAW.* 1737 (1976) [hereinafter First Report], reprinted in *AUDITOR'S LETTER HANDBOOK*, *supra* note 1, at 29.

17. *Id.* at 1742.

18. ABA Statement, *supra* note 1, at para. 6. The Code of Professional Responsibility has been replaced by the Model Rules of Professional Conduct.

19. First Report, *supra* note 16, at 1743.

20. The Audit Responses Committee listserv includes a number of threads from the past decade that involve discussions of dealing with new types of requests included in audit inquiry letters. Summaries of these discussion threads are posted on the Audit Responses Committee's Connect page (via connect.americanbar.org), and generally are published in issues of the ABA Business Law Section Legal Opinions Committee newsletter, *In Our Opinion*.

As a result, counsel is well-advised to scrutinize audit inquiry letters against the illustrative form of audit inquiry letter and against counsel's own form of audit response letter to ensure that counsel's audit response letter is clear as to its coverage.

Aside from the practical guidance, and perhaps most notably, the First Report includes a detailed discussion of a lawyer's audit response letter obligations with respect to unasserted claims and assessments, which have been a particularly tricky area over time as the nature and extent of government investigations have evolved.²¹

B. SECOND REPORT OF THE COMMITTEE ON AUDIT INQUIRY RESPONSES

Following up on the First Report, the Committee on Audit Inquiry Responses issued a "Second Report," which sought to address several additional areas of uncertainty and concern that were brought to the Committee's attention and left unaddressed by the First Report.²² Like the First Report, the Second Report was neither an interpretation, nor intended to modify any aspect, of the ABA Statement.

Again focusing on a lawyer's professional responsibility as addressed in Paragraph 6 of the ABA Statement, the Second Report responded to concerns that Paragraph 6 may place on the lawyer "unwarranted and unrealistic obligations in respect of unasserted possible claims."²³ The Second Report notes that Paragraph 6 is reflected in the audit procedures established under SAS No. 12 and makes clear that Paragraph 6 was prepared for guidance, not to establish prescriptive conduct for lawyers.²⁴ As the Second Report makes clear, "no lawyer is obliged to enter into an understanding with his client conforming to the ABA Statement of Policy, nor is he obliged to confirm to auditors that such an understanding exists; indeed, if no such undertaking by the lawyer is seriously intended, it would be entirely wrong for the lawyer to do either."²⁵ As with other issues under the ABA Statement, a lawyer following the ABA Statement in preparing an audit response letter can clarify the language of that letter and the understanding with the client and its auditors. Of course, "[i]n view of the desirability of avoiding differing versions of the same basic undertaking, and recognizing the attendant risks of unintended differences in meaning being derived

21. See, e.g., Stanley Keller, *Update on Dealing with Government Investigations in Audit Responses*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Spring 2018, at 17; Stanley Keller, *Dealing with Government Investigations in Audit Responses*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Fall 2016, at 14; Thomas W. White, *Mylan Settlement Shows Continuing SEC Focus on Disclosure of Government Investigations*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Fall 2019, at 13; Thomas W. White, *SEC Enforcement Case Applies Loss Contingency Accounting Standards to Government Investigations*, INSIGHTS: CORP. & SEC. L. ADVISOR, Feb. 2018, at 3.

22. *Second Report of the Committee on Audit Inquiry Responses Regarding Initial Implementation*, 32 BUS. LAW. 177 (1976) [hereinafter Second Report], reprinted in AUDITOR'S LETTER HANDBOOK, *supra* note 1, at 39.

23. *Id.* at 178.

24. *Id.*

25. *Id.*

from differences in wording and phrasing, it is hoped that such ad hoc variations will be found unnecessary or kept to a minimum.”²⁶

Also with respect to professional responsibility, the Second Report clarifies that lawyers are not required, under the ABA Statement, to determine “what should be included in financial statements or to undertake interpretation of FAS 5.”²⁷ However, as discussed below, recent court decisions interpreting ASC 450-20 have begun to graft additional understandings onto the financial statement footnote disclosure and accrual requirements, and these decisions can be relevant when lawyers are advising clients on client disclosure obligations.

Building upon the First Report’s discussion of unasserted claims, the Second Report offers guidance on dealing with pending investigations involving a client when “no charges against the client have been overtly threatened.”²⁸ This has become an area of increasing relevance in recent years as the nature of government investigations has evolved, but the basic principles set forth in the Second Report continue to apply and guide the responses of lawyers advising clients on such matters. For instance, the Second Report states the following position:

Where no charges have been made against the client or with respect to its conduct, such situations do not involve overtly threatened litigation, since there has not been manifested to the client an awareness of and present intention to assert a possible claim or assessment as contemplated by Paragraph 5(c) of the ABA Statement of Policy; for that reason, doubt has been expressed whether it is proper for the lawyer to describe the matter to the auditor when the client has not specifically requested comment thereon in the inquiry letter.²⁹

The overarching view of the Committee on Audit Inquiry Responses was that with respect to a particular client, consistency in approach should be followed until the auditor is advised otherwise of a change in approach—whether a lawyer regularly reports such matters or only reports those matters “as to which the client has determined the matter to involve an unasserted possible claim considered to be probable of assertion and to have a reasonably possible chance of an adverse result.”³⁰

Applying the ABA Statement’s construct in the context of government investigations has always been challenging, and has become even more challenging in recent years, in part because of uncertainties as to determining when a potential claimant has manifested to a client an awareness of and present intention to assert a possible claim or assessment against the client or as to the significance of a particular matter. Court decisions applying ASC 450-20 have spurred concerns in this regard, prompting clients to rethink their analysis of unasserted claims and, thus, raising concerns among lawyers in preparing audit response letters.

26. *Id.* at 179.

27. *Id.* at 183.

28. *Id.* at 185.

29. *Id.*

30. *Id.*

For instance, in *Indiana Public Retirement System v. SAIC, Inc.*,³¹ the Second Circuit held that under ASC 450-20-50-6, where there has been a “manifestation by a potential claimant of an awareness of a possible claim,” the threshold for disclosure of an otherwise unasserted claim was whether assertion of the claim was “reasonably possible,” not “probable.” In connection with a claim that SAIC failed to disclose the existence of a kickback scheme involving a New York City contract, the court held that the “manifestation of awareness” test was satisfied because the City of New York had publicly indicated its intent to consider claims against SAIC under the contract.³² Though the case interpreted the manifestation of awareness prong under ASC 450-20, lawyers need to consider its relevance to the disclosure framework in the ABA Statement.

More recently, in *SEC v. RPM International Inc.*,³³ the court denied defendants’ motions to dismiss the SEC’s complaint, which alleges that RPM and its general counsel failed to timely disclose a loss contingency, or record an accrual for, a Department of Justice (“DOJ”) investigation of a *qui tam* complaint that ultimately resulted in a \$61 million settlement. In its ASC 450 analysis, the court concluded that the SEC plausibly alleged that an “asserted claim” existed where the *qui tam* action had been filed and the company and its general counsel were aware of the complaint and knew that the DOJ was conducting an investigation to determine whether to intervene.³⁴ The court went on to explain that, even if there was only an “unasserted claim,” the government had manifested an awareness of a possible claim and thus the “reasonable possibility of assertion” standard applied to determine whether disclosure was required.³⁵ In reaching this conclusion, the court distinguished the case at hand from *In re Lions Gate Entertainment Corp. Securities Litigation*,³⁶ in which the court held that receipt of a Wells Notice regarding an SEC investigation did not constitute “pending or threatened litigation” for purposes of ASC 450-20, and instead analogized the case to *SAIC*.³⁷ The court also ruled, for purposes of the motions to dismiss, that the SEC’s complaint sufficiently alleged that a loss to the company was “probable” and “reasonably estimable” so as to require an accrual for the period where the company was aware of the *qui tam* complaint, had already calculated an amount of liability to the government, and had begun discussing settlement options with the DOJ.³⁸ While this case, like *SAIC*, deals with ASC 450-20, it is relevant in considering a lawyer’s responsibility when responding to auditors and advising clients regarding disclosure.

Looking at the bigger picture, the issues presented in these recent cases are undoubtedly challenging for lawyers and accountants and likely will continue

31. 818 F.3d 85, 93 (2d Cir. 2016), *cert. granted sub nom.* Leidos, Inc. v. Ind. Pub. Ret. Sys., 137 S. Ct. 1395 (2017), *cert. dismissed*, 138 S. Ct. 2670 (2018).

32. *Id.* at 93–94.

33. 282 F. Supp. 3d 1 (D.D.C. 2017).

34. *Id.* at 20.

35. *Id.* at 20–21.

36. 165 F. Supp. 3d 1 (S.D.N.Y. 2016).

37. *Id.* at 21.

38. *Id.* at 22.

to be difficult to navigate. As these cases illustrate, government investigations present their own unique issues, such as procedures that vary from agency to agency or the presence of *qui tam* complaints, where the information available to a client may initially be limited, all of which can further complicate the analysis.³⁹ Moreover, for public companies, the SEC has continued to focus on the timely accrual and disclosure of loss contingencies in accordance with the requirements of ASC 450-20, which provides a relevant context for lawyers to respond to auditor requests for information using the framework of the ABA Statement.⁴⁰ Ultimately, “[a]nticipating how an investigation is likely to play out and getting to the bottom of what underlies the investigation and determining its merits as quickly as possible is critical to exercising informed judgment about the need for and nature of the necessary disclosures by the lawyer to the auditors and by the client in its financial statements.”⁴¹

C. EMPHASIZING PROTECTION OF THE ATTORNEY-CLIENT PRIVILEGE

As described above, the ABA Statement strikes a delicate balance between avoiding potential waivers of the attorney-client privilege and responding to auditors’ needs for information to provide assurance on clients’ financial statements. There is a natural tension between these competing demands, and the ABA, through its committees, has had occasion to weigh in directly on this point.

In response to uncertainty or concern regarding the protection of attorney-client privilege following a “court case and other judicial decisions involving lawyers’ responses to auditors’ requests for information,” the Subcommittee on Audit Inquiry Responses of the Committee on Law and Accounting issued a report in December 1989 (the “1989 Report”) that offered some perspective.⁴² Grappling with a then-emerging practice of some lawyers and clients to include express language in their audit responses and inquiry letters designed to preserve evidentiary privileges, the 1989 Report posits that the inclusion of such additional language “simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver.”⁴³ As noted above, lawyers can modify language in the ABA Statement’s illustrative form of audit response letter, and doing so has been a relatively common practice for some time. The 1989 Report goes on to express the view that including such additional qualifying language, while not a guarantee that a court will not find a waiver to have occurred, does not interfere with the standards and

39. The Audit Responses Committee webpage (via connect.americanbar.org) includes a resource titled “Securities Disclosure in Qui Tam Cases” by John T. Boese, which addresses the applicable disclosure obligations in these kinds of cases.

40. See, e.g., Mylan N.V., SEC Litigation Release No. 24621 (Sept. 27, 2019), <https://www.sec.gov/litigation/litreleases/2019/lr24621.htm>.

41. Keller, *Dealing with Government Investigations in Audit Responses*, *supra* note 21, at 17.

42. *Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments: Auditing Interpretation AU Section 337*, 45 BUS. LAW. 2245 (1990), reprinted in AUDITOR’S LETTER HANDBOOK, *supra* note 1, at 49.

43. *Id.* at 2247.

procedures of the accounting profession in the audit process,⁴⁴ nor should it be construed as a limitation upon a lawyer's reply to auditors. Though no new guidance was issued by the 1989 Report, it did make clear that some modifications to illustrative forms of audit response letters and audit inquiry letters could be made and still be consistent with the ABA Statement. The 1989 Report thus illustrates another effort to achieve an accommodation between the legal and accounting professions.

Less than a decade later, members of the Subcommittee on Audit Inquiry Responses had another opportunity to address trends in audit letter practice, this time in response to an increase in references in audit inquiry letters to the absence of unasserted possible claims generally. Similarly to the 1989 Report, the "Third Report,"⁴⁵ issued December 17, 1996, referenced the illustrative form of response included in Annex A to the ABA Statement and recommended, as consistent with the consensus achieved with the accounting profession reflected in the ABA Statement, that lawyers include an express disclaimer of discussion of unasserted possible claims that were not specifically identified in the audit inquiry letter. As noted in the Third Report, the Committee on Law and Accounting engaged with the Auditing Standards Board of the AICPA, which adopted an interpretation of SAS 12 accepting and approving the Committee's recommended disclaimer language.

IV. RECENT RESPONSES TO ECONOMIC, MARKET, AND OTHER REGULATORY DEVELOPMENTS

Following the accounting scandals of the early 2000s involving Enron, WorldCom, and others, public scrutiny was directed toward the accounting profession, including auditor practices and the rules governing financial statement disclosures, resulting in, among other things, enactment of the Sarbanes-Oxley Act of 2002, which included creation of the Public Company Accounting Oversight Board.⁴⁶ Some of this scrutiny focused on loss contingency disclosures, attracting the attention of attorneys preparing audit response letters. At the 2004 Spring Meeting of the ABA Business Law Section, a preliminary meeting of a new Section Ad Hoc Committee on Audit Responses was held in response to these trends. Though the Committee indicated at the time that it "does not expect to propose or examine changes in the existing treaty with the accounting profession," it noted that "auditor requests of lawyers and clients now seem to be broadening. This trend requires attention."⁴⁷ Since then, a standing Audit Responses Committee (f/k/a Committee on Audit Responses) of the ABA Business Law Section was established to monitor such developments and weigh in on

44. See Codification of Statements on Auditing Standards, AU Section 9337.28–30 (Am. Inst. Certified Pub. Accountants 1990).

45. *Lawyers' Replies to Auditors: Guidance on the Privilege Issue*, BUS. L. TODAY, Sept./Oct. 1996, at 64, reprinted in AUDITOR'S LETTER HANDBOOK, *supra* note 1, at 57.

46. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 & 29 U.S.C.).

47. *Audit Responses*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), June 2004, at 3.

issues as they developed to advocate for the basic agreement reached between the legal and accounting professions decades ago.

The modern-day Audit Responses Committee has been actively engaged over approximately the last decade on a number of developments affecting auditing and accounting that directly impacted or could have directly impacted audit letter practice. As a useful tool for practitioners, a significant number of questions have been raised and resolved by discussion on a listserve maintained by the Committee. These discussions generally are summarized on the Committee's webpage and published in issues of the ABA Business Law Section Opinions Committee newsletter, *In Our Opinion*.⁴⁸ Other developments were addressed more formally, including adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109* (“FIN 48”), proposed amendments to ASC 450-20 that would have expanded the disclosure required for loss contingencies but were not adopted,⁴⁹ increased requests for updated audit response letters, and other changes in audit practice related to audit response letters.

A. STATEMENT ON EFFECT OF FIN 48 ON AUDIT RESPONSE LETTERS

In 2006, FASB issued FIN 48, which provided guidance for accounting for uncertainty in income taxes and made clear that such guidance controls over FAS 5.⁵⁰ The Audit Responses Committee took the view that FIN 48 did not change the standards under which lawyers should prepare audit response letters, as explained in greater detail in the *Statement on Effect of FIN 48 on Audit Response Letters*, but it did agree that “FIN 48 can affect the way a lawyer advises his or her client when income tax matters are involved.”⁵¹

FIN 48 modified the accounting treatment for income tax uncertainty from the loss contingency model under FAS 5, most notably in that it required clients to report an income tax loss contingency in their financial statements for the portion of a tax position that is not “more likely than not” to be sustained upon examination by the applicable taxing authority.⁵² Importantly, FIN 48 presumes that a client's tax position will be examined by applicable taxing authorities with full knowledge of relevant information. Thus, unlike in the context of contingent liabilities analyzed under FAS 5, a client's judgment about the probability of a tax uncertainty becoming an asserted claim or assessment is irrelevant. Lawyers preparing audit response letters should be aware of this nuance, “and if the lawyer has concluded that financial statement disclosure of the income tax contingency is required but is not satisfied that the auditor has been or will be made aware of the contingency, the lawyer should consider what action is appropriate

48. A full archive of *In Our Opinion* can be accessed via https://www.americanbar.org/groups/business_law/migrated/committees/CL510000pub/newsletter/.

49. See text at *infra* note 55.

50. FIN 48 is now codified as ASC 740.

51. *Statement on Effect of FIN 48 on Audit Response Letters*, *supra* note 14, at 389.

52. *Id.* at 391.

as a matter of professional responsibility. Such action might include, depending on the circumstances, refraining from providing the audit response letter and possibly withdrawing from the engagement.”⁵³

B. FASB CODIFICATION AND PROPOSED AMENDMENTS TO ASC 450-20

In 2009, FASB codified its accounting standards under the unified Accounting Standards Codification. While the codification did not substantively change the accounting standard for loss contingencies or affect the audit response letter process, the Audit Responses Committee issued a statement to offer some guidance for translating references to FAS 5 in the ABA Statement, including those in the illustrative forms of response.⁵⁴

The ABA Audit Responses Committee’s engagement with FASB, along with that of other ABA groups, significantly increased when FASB, in 2010, proposed amendments to ASC 450-20 shortly following the codification of FAS 5 as ASC 450. Those proposed changes to the standards for disclosure of loss contingencies would have significantly increased the disclosure burden on companies facing litigation, potentially requiring a number of prejudicial disclosures and eroding the attorney-client privilege. In a September 20, 2010, comment letter by the ABA,⁵⁵ six objectives were advanced for FASB’s consideration, which the comment letter argued “are as important now as they were when the ABA Statement and SAS No. 12 were adopted and need to be preserved.” These included:

- Taking a principles-based approach to establishing financial accounting disclosure requirements.
- Recognizing that the litigation process, particularly in the United States, is “fraught with uncertainties” and that such uncertainties are what can account for loss contingency surprises, not disclosure failures.
- Materiality must be the touchstone of any disclosure regime.
- Prejudicial disclosures “should not be required unless that information is necessary so that the financial statements are not misleading.”
- Mandating unnecessary disclosures can become a source of liability and should be avoided, such as requirements to disclose information that requires speculation or prediction, particularly without a statutory forward-

53. *Id.* at 392.

54. *Statement on Effect of the FASB Codification on Audit Response Letters*, 65 *BUS. LAW.* 491 (2010), reprinted in *AUDITOR’S LETTER HANDBOOK*, *supra* note 1, at 65.

55. Comments of the American Bar Association on the Financial Accounting Standards Board Proposed Accounting Standards Update Titled “Disclosure of Certain Loss Contingencies,” File Reference No. 1840-100 (Sept. 20, 2010) (on file with authors) [hereinafter 2010 ABA Comment Letter]. For the proposed amendments that were never adopted, see *Fin. Accounting Standards Bd., Exposure Draft: Proposed Accounting Standards Update—Contingencies (Topic 450)* (July 20, 2010).

looking information safe harbor that applies to financial statement disclosures.

- Protecting the attorney-client privilege must remain a priority.⁵⁶

The comment letter went on to provide specific comments on the details of FASB's proposal. It also discussed the anticipated effect that FASB's proposal would have on the ABA Statement. Notably, the ABA posited that "we do not at this time believe that the revisions proposed in the Revised Exposure Draft, as we understand them, or as they may be revised to reflect our recommendations, would require any changes to the ABA Statement."⁵⁷ The ABA went on to say, "the ABA Statement has stood the test of time and has been successful in achieving its purposes." Such purposes were described to include "providing information to auditors regarding specified loss contingencies and allowing auditors to rely upon counsel having fulfilled their professional responsibility to advise the client, when appropriate in connection with counsel's engagement, regarding the client's disclosure obligations, while, at the same time, maintaining client confidences and ensuring preservation of the fundamental protections of the attorney-client privilege and the work product doctrine."⁵⁸

In commenting on FASB's proposal to require disclosure of asserted claims for which the likelihood of an unfavorable result is remote but nevertheless could have a potentially severe impact, the ABA noted again that no change would be required to the ABA Statement because "[t]he ABA Statement contemplates that counsel, when requested by the client, will identify all material asserted claims to which counsel has devoted substantive attention without regard to their likely outcome. . . . Similar to counsel having the professional responsibility to advise counsel's client regarding disclosure of unasserted claims, counsel has the professional responsibility to advise the client regarding disclosure of asserted claims when that is within the scope of his or her engagement."⁵⁹ The ABA indicated, however, that even though it believed no change to the ABA Statement would be necessary, if FASB were to change the applicable disclosure threshold, the Audit Responses Committee likely would issue a statement to "make clear that a lawyer would need to take that change into account in advising the client, to the extent within the scope of the lawyer's engagement, regarding the client's disclosure obligation with respect to asserted remote claims."⁶⁰ FASB ultimately abandoned the proposed amendments in 2012.⁶¹

56. 2010 ABA Comment Letter, *supra* note 55, at 24.

57. *Id.* at 10.

58. *Id.* at 10–11.

59. *Id.* at 11.

60. *Id.*

61. For a brief discussion of the vote to terminate the proposed rulemaking project, see Stanley Keller, *FASB Ends Loss Contingencies Project*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Summer 2012, at 8.

C. STATEMENT ON UPDATES TO AUDIT RESPONSE LETTERS

As emphasis on loss contingency disclosures continued to increase, so too did requests for updates to lawyers' audit response letters, particularly following the 2008 financial crisis. In 2015, the Audit Responses Committee issued its *Statement on Updates to Audit Response Letters* (the "Statement on Updates"), which contextualized the reasons for the update requests, including changes in accounting standards regarding the dating of audit reports, which affected the dates through which auditors seek audit evidence,⁶² and assembled guidance for preparing audit response update letters based on the framework set out in the ABA Statement.⁶³ As a foundational matter, the Statement on Updates makes clear that "[a] lawyer's update to an audit response letter is subject to the ABA *Statement of Policy* and should be prepared and delivered in accordance with its terms."⁶⁴ Accordingly, many of the same considerations that go into preparing an initial audit response letter apply to an update, including those with respect to obtaining client consent, conducting internal procedures to prepare the update, and delivering a written response to the auditors (as opposed to an oral update). Unlike an initial audit response letter, however, the Audit Responses Committee has not proposed a form of update letter, and the Statement on Updates notes that "many different forms are in common use," with some lawyers preferring a "long form" approach similar to an initial audit response letter, while others take a "short form" approach that typically includes a reference to information in a previous letter. While there is no one correct approach, the Statement on Updates cautions that "short form" updates should "(1) refer to the relevant client request(s), the entity or entities covered by the response, and the most recent long form response letter and previous update letters, if any, identifying them by date, and (2) state expressly that the response is subject to the same limitations and qualifications contained in the earlier letter."⁶⁵

62. In connection with its adoption of its Auditing Standard No. 5 in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard AU 530 to provide that "[t]he auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion." Interim Auditing Standards, AU Section 530.01 (Pub. Co. Accounting Oversight Bd. 2007). Previously, AU 530 had provided that generally the date of completion of the field work should be used as the date of the report. See Proposed Auditing Standard—An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), http://pcaobus.org/Rules/Documents/2006-12-19_ReleaseNo._2006-007.pdf. The PCAOB also amended its Interim Auditing Standards to provide that "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." Interim Auditing Standards, AU Section 9337.05 (Pub. Co. Accounting Oversight Bd. 2007). Previously, the standard had said that the effective date should be "as close to the completion of field work" as practicable in the circumstances. Interim Auditing Standards, AU Section 9337.05 (Pub. Co. Accounting Oversight Bd. 2003).

63. *Statement on Updates to Audit Response Letters*, 70 *Bus. Law.* 489 (2015).

64. *Id.* at 492.

65. *Id.* at 493.

D. OTHER DEVELOPMENTS

In recent years, a number of other developments have affected auditing practice. In 2017, the PCAOB and SEC approved a significant change to the form of auditor's report for public company audits for the first time in decades. This change introduced the requirement for auditors to disclose critical audit matters, known as CAMs, in their standard auditor's report.⁶⁶ Leading up to and following adoption, the Audit Responses Committee has monitored the standard and engaged in discussions with key actors in the legal and accounting professions to discuss its potential impact. The Audit Responses Committee continues to monitor developments in this regard, as it has done with other changes in auditing and accounting practice.⁶⁷

Similarly, in response to the advent of new auditing technologies designed to streamline the audit response letter process, in 2017, the Audit Responses Committee issued a *Statement Regarding Electronic Audit Response Request and Delivery Platforms*,⁶⁸ which answered a number of questions commonly asked by law firms. Similar to other statements by the Audit Responses Committee, the 2017 Statement offered general observations with respect to the interplay between the basic framework of the ABA Statement and such online platforms. The Audit Responses Committee did not endorse the use of any particular online platform and encouraged lawyers to make their own assessments of any such platform.

V. CONCLUSION

In the over forty years since approval of the ABA Statement, significant changes have taken place and likely will continue to take place affecting the responsibilities, exposure to litigation, and regulation of accountants; professional standards governing lawyer conduct; disclosure requirements for public companies; and auditing and accounting standards. As the various statements and reports of the Audit Responses Committee (and its predecessor ABA committees and subcommittees) illustrate, many of which have been published in *The Business Lawyer*, the ABA Statement has proven to be adaptable to these changes and

66. See Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules on the Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and Departures from Unqualified Opinions and Other Reporting Circumstances, and Related Amendments to Auditing Standards, Exchange Act Release No. 81916, 82 Fed. Reg. 49886 (Oct. 23, 2017); The Auditor's Report on an Audit of Financial Statements When the Auditor Express an Unqualified Opinion and Related Amendments to PCAOB Standards, PCAOB Release No. 2017-001 (June 1, 2017).

67. See Thomas W. White, *Will the PCAOB's New Audit Report Standard Affect Audit Letter Practice?*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Summer 2017, at 13; see also, e.g., Stanley Keller, *Memorandum on Audit Responses Regarding Environmental Loss Contingencies*, IN OUR OPINION (ABA Bus. Law Section Legal Ops. Comm.), Spring 2013, at 8.

68. ABA Bus. Law Section Audit Responses Comm., *Statement Regarding Electronic Audit Response Request and Delivery Platforms* (Feb. 24, 2017) (unpublished manuscript available at <https://connect.americanbar.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=7e48b7c7-dd9e-7c9f-ca08-f6678d12b4b0&forceDialog=0>).

has continued to fulfill its intended purposes. This history provides a bedrock foundation upon which to analyze future developments in the areas of auditing and accounting. Though challenges will arise, the foundational principles undergirding the ABA Statement should continue to offer the necessary framework within which to analyze these developments.