

CONCORDIA UNIVERSITY

The Legal Letter Case Analysis

John Molson School of Business

ACCO 465 Section A

**PRESENTED TO:
Professor Sophie Audousset - Coulier**

November 11, 2015

To: Engagement Partner

From: Senior Auditor

Client: ABC Inc.

Subject: Concerns regarding Legal Confirmations & Accompanying Recommendations

Dear Engagement Partner,

As you know, I am in the process of completing ABC Inc.'s year end financial statement audit. I am writing to you to inform you on a significant issue that has come to light. Unfortunately, our client's lawyer is refusing to provide us with any legal information that would help us assess ABC's contingent liabilities, as he feels it will breach his client-lawyer confidentiality. As a result, this is preventing me from proceeding with the audit. Thus, below you will find my concerns as well as my suggested course of action in order to resolve the issue at hand.

Concerns

Client-Lawyer Relationship

Naturally, a lawyer has a fiduciary duty to act in the best interest of his client and to maintain confidential information, unless consent is provided. As you know, the legal confirmation letter was recently prepared on ABC's letterhead and signed by management, which thereby waives the privilege of confidentiality and gives the lawyer permission to provide our audit firm with the relevant information needed. However, I feel as though the lawyer has failed to understand this, as he insists on withholding his opinions on any possible and outstanding claims.

Disclosure of Contingent Liabilities

Before proceeding, I would like to inform you that I noticed a significant increase in legal fees while conducting our client's audit, thus increasing the importance of this issue. As a result, I am worried that contingent liabilities may be understated. If this is the case, then, the legal confirmation response will be even more crucial to our audit. Therefore, should we fail to collect

this important information from the lawyer, I am concerned that this may prevent us from thoroughly assessing the completeness and likelihood of these liabilities, as well as the reasonableness of the liability estimates made by management.

Specific Format

As you are aware, a legal confirmation letter must follow a strict and specific format, including a list of outstanding and possible claims prepared by management, along with their related evaluation of the likelihood of losses for each claim. Due to the specific letter format required, I feel as though there is a higher probability that the letter may be inaccurate or incomplete, which could potentially be causing the lawyer's denial of response. Based on the information provided to me, it seems as though management is requesting a summary and outcome of each claim, thereby demanding information beyond the scope of the lawyer's duty. Both you and I are aware that the lawyer must only assess whether or not the estimates of each claim prepared by management are reasonable. As a result, this may be linked to the lawyer not responding. Similarly, ABC's lawyer may be inexperienced with this type of work or feel his required task is unclear. Additionally, there may have been no indication to send a signed copy of the reply to the auditor, all possibly resulting in the lawyer's denial of response.

Misunderstanding

For the reasons described above, it leaves me to believe that there has been a possible misunderstanding between our client and their lawyer's duty. I have thus come up with a few courses of action listed below, that I would like to run by you and receive your feedback.

Initial Course of Action

Follow up with Lawyer

In order to clarify the possible misunderstanding, I do suggest following up with the lawyer, by scheduling a meeting in person. This will avoid the continuous and inefficient back and forth communication through phone calls, letters or emails. For one, an in person conference will allow us to explain to the lawyer his task, as well as, the purpose and importance of the legal confirmation for our audit. I highly suggest we commence by explaining to him that, similar to

lawyers who need to obey certain duties, we, as auditors, must also abide by certain standards. More specifically, we can describe to him that under CAS 501, it is a requirement to perform procedures identifying litigation and claims against the auditee, illustrating the importance of this letter. Should the lawyer be unaware of what a contingent liability entails, we will be sure to provide him with a description as well as the criteria that meet the definition of one. We can then continue to describe the purpose of the legal letter, in that, it provides us with evidence about any potential material claims against the auditee, enables us to determine if management's estimates of the claims are reasonable and helps us assess whether there are any unrecorded liabilities that should in fact be reported in the financial statements.

Since one of our major concerns listed above was the lawyer's failure to understand the client-lawyer confidentiality rules, I do believe we must explain to the lawyer that the letter provided by management grants him with the permission to communicate with our firm and as a result, does not breach his client-lawyer confidentiality.

We should also take this time to familiarize him with our duty as auditors, in that, we too, cannot disclose, quote or reveal any confidential information obtained from the lawyer to third parties. I feel this is important as he fears that his opinion on any lawsuit will be used against his client by the opposing side.

Following Course of Action

Scenario A: We do obtain lawyer confirmation

If, after the follow up, the lawyer is understanding, which I hope he is, and finally provides us with this vital legal confirmation, then, we can move forward with the final steps of ABC's audit. This would evidently be the ideal situation and would resolve our initial concerns.

Scenario B: We do not obtain lawyer confirmation

However, due to the lawyer's rude and abrupt character, there is a possibility that even after our follow up, he may not want to provide us with the necessary legal information requested. If

this is the case, then, I will obtain alternative documents, listed below, in order to complete our audit.

1. Enquire and discuss with management on any litigation issues as well as their policies and procedures for identifying, evaluating and accounting for litigations,
2. Read minutes of meetings of shareholders, directors and committees to obtain any information regarding litigations and,
3. Obtain assurance from management that it has disclosed all material possible and outstanding claims in the form of a management representation letter.

The latter is essential since the lawyer is not required to identify any omissions of possible claims. On a side note, I do feel we should still obtain a management representation letter as a supporting document to our audit, even if we do receive the lawyer's response. Both you and I are aware that, as auditors, we have the right to expect to be informed by management about all material contingent liabilities.

If the above alternative documents provide us with sufficient evidence despite not having received the lawyer's letter, then, we can still issue an unqualified opinion. However, we both know that this is a rare occurrence. Evidently, if the alternative documents do not provide us with sufficient evidence, it will be necessary to issue a scope limitation.

I do hope the lawyer understands the importance of the confirmation letter and thus, provides us with the necessary information. I will keep you updated with any other issues that arise during the rest of ABC's audit. In the meantime, I will be awaiting your response.

Regards,

Senior Auditor, CPA
Senior Auditor