

Exhibit C — Statement on Updates to Audit Response Letters*

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By Audit Responses Committee, ABA Business Law Section

Requests for updates to lawyers' audit response letters have become more frequent in recent years. Typically, the client's audit inquiry letter to its lawyers calls for a response before the anticipated issuance date of the audited financial statements. An "update" or "bringdown" is an audit response letter provided to the auditor in which a lawyer provides information about loss contingencies as of a date after the date of the lawyer's initial response to the audit inquiry letter and any previous update.

The *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests*¹ does not specifically discuss updates to audit response letters. In view of the increased frequency of update requests and the lack of guidance regarding these requests, the ABA Business Law Section Audit Responses Committee has prepared this statement to outline the reasons auditors seek updates of audit response letters and to present the Committee's views on appropriate practices for responding to update requests under the *ABA Statement of Policy*. The Committee hopes that the guidance provided in this Statement will enhance the ability of lawyers to respond efficiently to update requests, thereby facilitating the audit process and contributing to audit quality.

The Reasons for Update Requests

The *ABA Statement of Policy*, including its reference to accounting and auditing standards, provides the framework for lawyers' audit response letters. The *ABA Statement of Policy* recognizes the fundamental importance to the American legal system of maintaining client confidences. It makes clear that lawyers may provide information to auditors only at the request, and with the express consent, of their clients.² In accordance with the *ABA Statement of Policy*, lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.³ The *ABA Statement of Policy* also contemplates that

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¹ *American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) [hereinafter *ABA Statement of Policy*], reprinted in ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK 1 (2d ed. 2013).

² *Id.* at 2–3 (¶ 1).

³ *Id.* at 3 (¶ 2) ("It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention.").

“the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning” loss contingencies.⁴

In recent years, requests for updates have become standard procedure for many auditors. This reflects changes in applicable accounting standards and auditing practices, as well as increased emphasis on loss contingencies by the Securities and Exchange Commission (“SEC”) and Financial Accounting Standards Board (“FASB”), which in turn has increased auditors’ focus on loss contingencies. Requests for updates to audit response letters typically are made in three contexts:

- *Audit of annual financial statements.* Changes to financial reporting standards require the issuer of financial statements to evaluate “subsequent events,” which can include changes in loss contingencies, through the date the financial statements are issued or are available to be issued.⁵

As a result of changes in auditing practices,⁶ most auditors’ reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which

⁴ *Id.* Although a law firm’s or law department’s internal review procedure may include canvassing lawyers who performed services for a client from the beginning of the fiscal period under audit, many firms or departments limit their response to matters existing at the end of that period or arising after the end of the period. This approach is based upon the statement in the typical request letter to the effect that the response should include matters that existed at the end of the fiscal period under audit and during the period from that date to the date as of which the response is given. See INTERIM AUDITING STANDARDS, AU § 337A (Pub. Co. Accounting Oversight Bd. 2003) (illustrative audit inquiry letter); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 501.A69 (Am. Inst. of Certified Pub. Accountants 2011) (illustrative audit inquiry letter). Thus, under this approach, matters resolved during the fiscal period, which no longer comprise “loss contingencies” at or after the fiscal period end date, are not reported.

⁵ See SUBSEQUENT EVENTS, Accounting Standards Codification, Topic 855 (Fin. Accounting Standards Bd. 2010) [hereinafter ASC 855]. ASC 855 codifies a prior accounting standard on subsequent events. See SUBSEQUENT EVENTS, Statement of Fin. Accounting Standards, No. 165 (Fin. Accounting Standards Bd. 2009) [hereinafter SFAS 165]. Notably, SFAS 165 amended the accounting standard governing contingencies. See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975), amended by SFAS 165, ¶ B3 (codified as CONTINGENCIES, Accounting Standards Codification, Topic 450 (Fin. Accounting Standards Bd. 2009)) [hereinafter ASC 450]. As amended, ASC 450 provides that, in assessing the accounting for a loss contingency, the reporting entity must consider information available through the date the financial statements were issued or available to be issued. *See id.* 450-20-25. Under ASC 855, for SEC filers, financial statements are “issued” on the date they are filed with the SEC; for non-SEC filers, they are “available to be issued” when they are complete and all internal approvals for issuance have occurred. ASC 855-10-25. ASC 855 also requires that entities disclose in the financial statements the date through which they evaluated subsequent events. *See id.* 855-10-50.

⁶ In connection with its adoption of Auditing Standard No. 5 in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard AU 530 to provide that “the 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 § 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*

fieldwork is completed. Accordingly, the auditor may seek to obtain audit evidence, in the form of audit letter updates, to corroborate management's identification of and accounting for loss contingencies as of the issuance date.

- *Review of quarterly financial statements.* As with annual financial statements, an issuer is required to consider subsequent events, including loss contingencies, through the date of issuance of its quarterly financial statements. SEC rules require that quarterly financial statements be reviewed by the issuer's external auditors in accordance with relevant auditing standards.⁷ Although they are not ordinarily required to do so,⁸ auditors may request confirmation from counsel about loss contingencies as part of their internal procedures before they will sign off on the filing of quarterly financial statements with the SEC.
- *Consents in connection with registered securities offerings.* Auditors must consent to the use of their audit reports in registration statements for public offerings of securities. Auditing standards require the auditors to perform certain procedures before consenting to the inclusion of a previously issued audit report in a registration statement or amendment to a registration statement.⁹ Although these standards do not require an auditor to make inquiries of lawyers, before issuing a consent, many auditors ask lawyers to update their audit response letters. In offerings involving shelf takedowns, the auditors may request one or more updates in connection with their delivery of "comfort letters" to underwriters.

The foregoing explains the increased frequency of auditors' requests for updates. However, the experience of many lawyers suggests that auditors (and sometimes clients) do not always appreciate the need for lawyers to perform internal procedures to be able to deliver an update.

Lawyers' Responses to Update Requests—A Framework

Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), available at http://pcaobus.org/Rules/Documents/2006-12-19_Release_No._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 § 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 § 9337.05 (Pub. Co. Accounting Oversight Bd. 2003).

⁷ Regulation S-X, Rule 10-01(d), 17 C.F.R. § 210.10-01(d) (2014).

⁸ See INTERIM AUDITING STANDARDS, AU § 722.20 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF AUDITING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 100, AU § 722.20 (Am. Inst. of Certified Pub. Accountants 2002), *superseded by* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 930.15 (Am. Inst. of Certified Pub. Accountants 2011).

⁹ See INTERIM AUDITING STANDARDS, AU § 711 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 925 (Am. Inst. of Certified Pub. Accountants 2011).

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. This has several implications.

Client Requests for Updates to Audit Response Letters. As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. The lawyer should be satisfied that the client has provided the necessary authorization for the update. The Committee does not believe that any specific form of authorization is necessary, so long as it expresses the client's intent that the lawyer deliver an update to the lawyer's response letter to the auditor. A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such requests.

Standing Requests. In some cases, a client's initial request letter may contain a standing request that the lawyer deliver updates to response letters upon request by the auditor. The inclusion of such a request can facilitate the audit response process. Many lawyers view a client request to provide information to the auditors in connection with the audit of the annual financial statements to include an implicit standing request to respond to update requests related to issuance of those financial statements. Other lawyers require a separate authorization for every update, absent a standing request.

The Committee believes that lawyers may provide an update on the basis of a standing request, but recognizes that in some circumstances they may want a specific request or consent from the client. Among those circumstances are (1) when significant time has elapsed since the initial request, and (2) when developments have occurred that would be required to be reported in the update, such as pending or threatened litigation that has arisen since the previous response or significant developments in previously described pending or threatened litigation, and the lawyer believes the client should be consulted before issuing the update response.

Preparation of Updates to Audit Response Letters. The Committee recognizes that circumstances may allow lawyers significantly less time to prepare an update than they had for the initial response letter. Still, clients and auditors should recognize that because, from the lawyers' standpoint, each update is tantamount to reissuance of the initial response letter, lawyers may have to perform internal review procedures similar to those performed for the initial response letter. Those may include inquiring again of lawyers in the law firm or law department who may have relevant information. Clients should be encouraged to communicate with their lawyers and the auditor when the client becomes aware of a filing or transaction that will require an update to an audit response letter, so that the lawyers have adequate time to perform sufficient internal review procedures to provide the update.¹⁰

¹⁰ See *ABA Statement of Policy*, *supra* note 1, at 9–10 (commentary ¶ 2) (“The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer’s engagement and the complexity and magnitude of the client’s affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client’s affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the

The internal procedures lawyers perform to issue an update will depend on the particular circumstances and the professional judgment of the lawyers involved as to what is necessary. For example, some law firms or law departments may canvass the lawyers who provided information reflected in the earlier response to the audit inquiry letter, even if those lawyers have not subsequently recorded time for the client. Other firms or law departments may only canvass lawyers who have performed legal services for the client since the cutoff date for the last internal inquiry and any other lawyers they believe are likely to have relevant information. The Committee believes that either approach is acceptable. The Committee recognizes that the professional judgment of lawyers may lead to different procedures in particular cases, which might involve varying types and amount of inquiry and documentation.

Form of Updates to Audit Response Letters. Updates ordinarily should be delivered in writing, not communicated orally. Any update to an audit response letter should be made in accordance with the *ABA Statement of Policy*, including its conditions and limitations. Unlike lawyers' initial responses to audit inquiry letters, no illustrative form of update response has been established, and many different forms are in common use.

Some lawyers regularly use a "long form" response letter that employs the same form as the initial response letter but provides information about loss contingencies as of an effective date after the effective date of the previous letter. Others use a "short form" letter that does not contain all the language of a long-form letter, but rather references the information in the previous letter and identifies any reportable developments with respect to previously reported loss contingencies or reportable loss contingencies that have arisen since the prior effective date. Finally, some lawyers have adopted a hybrid approach under which they use a short form in some circumstances and a long form in others; these lawyers may use a short form when they have no developments to report since the previous response letter and a long form when additional information about loss contingencies (whether previously reported or new) needs to be reported.

If a short form is used, the Committee suggests that it 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. Nothing in this statement is intended to limit the professional judgment of a lawyer regarding the form the lawyer uses to update an audit response letter.

[Paragraph added, June 2015, to reflect *Statement on Updates to Audit Response Letter* by the Audit Responses Committee of the American Bar Association.]

response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.").