QUANTIFYING LITIGATION RISK FOR THE AUDIT COMMITTEE

A Practical Framework for
CFOs and General Counsel

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Litigation is no longer just a legal department issue. For listed and privately held businesses alike, claims and regulatory investigations drive provisions, covenant headroom, investor confidence and, in some cases, strategic options. Yet audit committees often receive litigation updates that are descriptive rather than analytical – case-by-case narratives without a clear sense of portfolio risk, financial impact or decision points.

This insight sets out a practical, board-ready framework for quantifying litigation risk, designed for CFOs, General Counsel and audit committee chairs. The aim is not to turn legal uncertainty into false precision, but to move from anecdote to structured, repeatable assessment that can be defended with regulators, auditors and investors.

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1. Why litigation risk belongs on the audit committee agenda

1.1 From anecdote to measurable exposure

Litigation risk sits at the intersection of legal, financial and governance responsibilities. Individual cases may arise from commercial relationships, employment decisions, regulatory issues or corporate transactions – but their impact is ultimately felt in earnings volatility, provisioning, disclosure and capital allocation.

For audit committees, the key questions are:

- What is our aggregate exposure to litigation and investigations?
- How does that exposure move over time?
- What decisions are we taking – or deferring – in response?

A structured litigation risk assessment framework allows those questions to be answered in a way that aligns with wider risk management and financial reporting processes, rather than relying solely on narrative updates from in-house or external counsel.

1.2 Regulatory, financial and reputational pressures

Audit committees are increasingly expected to demonstrate that legal risks are understood, monitored and addressed in line with governance and regulatory standards. That expectation is intensified where the business operates in regulated or high-risk sectors, or where disputes intersect with issues such as ESG, culture and executive conduct.
Key drivers include:

- Accounting standards on provisions and contingent liabilities.
- Regulatory scrutiny of how firms respond to misconduct and control failures.
- Investor focus on litigation “overhang” in valuations and deal negotiations.
- Reputational sensitivity where disputes touch on customers, employees or public policy.

Against that backdrop, qualitative descriptions of “material” or “high-profile” cases are no longer sufficient. Audit committees need a litigation risk framework that is consistent with the organisation’s broader risk register and appetite.

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2. Common challenges in quantifying litigation risk

Before designing a framework, it is useful to acknowledge the typical obstacles CFOs and GCs face:

- Inherent uncertainty: Legal outcomes depend on facts, law, judges, regulators and counterparties – all of which can shift.
- Information asymmetry: Boards may see only a snapshot, with underlying documents, advice and negotiations filtered through multiple layers.
- Inconsistent language: Terms such as “strong”, “defensible” or “good prospects” are used differently by different lawyers and business units.
- Siloed reporting: Regulatory investigations, commercial disputes, employment claims and class actions may be reported through separate channels.
- Pressure from auditors and regulators: Demands for clearer provisioning rationales and documentation can clash with privilege and litigation strategy.

A practical litigation risk assessment for audit committees needs to address these challenges without overwhelming the board with legal detail.

3. Step 1 – Build a clear litigation risk inventory

3.1 Define the scope of "litigation risk"

Start by agreeing what will be captured in the litigation risk inventory. At a minimum, consider:

- Active litigation: Court and arbitration proceedings (as claimant or defendant).
- Regulatory and enforcement matters: Investigations, supervisory interventions and enforcement actions.
- Threatened claims: Formal letters before action and disputes where external lawyers are already involved.
- Structural exposures: Issues likely to generate multiple similar claims (for example, product, customer, employment or data-handling issues).

Some organisations also include "legal near-misses" – incidents that did not result in claims but revealed control gaps – to support thematic analysis and remediation.

3.2 Classify the portfolio in a consistent way

For audit committee purposes, the goal is not to replicate legal case files but to create a manageable portfolio view. Each matter in the inventory should be tagged using a small set of consistent fields, for example:

- Business unit or geography.
- Type of dispute (commercial, regulatory, employment, IP, tax, etc.).
- Counterparty type (customer, supplier, regulator, employee, investor).
- Forum (High Court, arbitration, tribunal, regulatory process).
- Strategic importance (for example, linked to a key contract, product or jurisdiction).

This taxonomy underpins later portfolio analysis and helps identify concentrations of litigation risk in particular parts of the business.

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4. Step 2 – Apply consistent probability and impact bands

4.1 Calibrating likelihood: from “gut feel” to structured assessment

Audit committees do not need – and should not expect – precise probabilities for each matter. What they do need is a consistent way of understanding likelihood across the portfolio.

A simple three- or four-band scale is usually sufficient, for example:

- Remote: Outcome adverse to the company is considered unlikely.
- Possible: Outcome adverse to the company could occur.
- Probable / more likely than not: Outcome adverse to the company is more likely than not.

Behind those labels, General Counsel should develop internal guidance so that external and internal lawyers use them consistently. That guidance can refer to prospects of success, evidential risks, counterparty behaviour and procedural posture (for example, pre-action vs post-trial).

4.2 Assessing impact: financial and non-financial

For each matter, impact should be assessed on both:

- Financial dimensions, such as:
  - Best estimate of potential liability (or recovery if claimant).
  - Range of outcomes (for example, low, mid and high scenarios).
  - Associated costs (legal fees, expert costs, management time).
  - Effect on covenants, capital ratios or transaction feasibility.

- Non-financial dimensions, such as:
  - Reputational exposure and media interest.
  - Regulatory or political sensitivity.
  - Implications for key relationships (regulators, major customers, strategic suppliers).
  - Precedent risk (whether a decision could trigger further claims).

Impact can be rated using a banded system aligned with the organisation’s overall risk appetite and risk register – for example, “minor”, “moderate”, “major”, “severe” – with reference thresholds agreed between the CFO, GC and risk function.

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5. Step 3 – Connect litigation risk to financial reporting and capital allocation

5.1 Provisions, contingencies and disclosures

Once probability and impact bands are in place, litigation risk assessment can be linked more directly to financial reporting decisions. For example:

- Probable and quantifiable liabilities may inform provisions.
- Possible but not probable exposures may inform contingent liability disclosures.
- Remote risks may still require narrative disclosure if strategically significant.

The CFO and GC should agree:

- Thresholds for including matters in the financial reporting pack.
- How to handle ranges of outcomes and sensitivities.
- The documentation required to support provisioning and disclosure judgments in dialogue with auditors and regulators.

5.2 Scenario analysis and stress testing

For portfolios with significant litigation or regulatory exposure, audit committees may request scenario analysis, such as:

- “Base case” (expected outcomes).
- “Downside case” (clustered adverse outcomes).
- “Reverse stress” case (assumption that several high-impact matters crystallise simultaneously).

This helps boards understand whether litigation risk could meaningfully affect liquidity, leverage, dividend policy, investment capacity or strategic flexibility.

6. Step 4 – Governance: who owns litigation risk?

6.1 Roles of General Counsel, CFO and audit committee

Clear ownership is critical to making a litigation risk framework work in practice:

- General Counsel typically owns the methodology for assessing legal risk, quality control over advice and engagement with external counsel.
- The CFO owns translation of that risk into financial metrics, provisioning, capital planning and investor messaging.
- The audit committee oversees the framework, challenges assumptions and ensures that litigation risk is integrated into the wider risk and governance structure.

These roles should be documented in governance materials, including risk committee mandates, reporting calendars and, where necessary, internal policies on escalation and approvals.

6.2 Data, dashboards and reporting cadence

Moving from an annual "litigation update" to a disciplined reporting rhythm can materially improve oversight:

- Standardised dashboards summarising the portfolio, highlighting movements in probability, impact and key assumptions.
- Exception-based reporting for new matters above a defined threshold, or where risk levels or strategic importance change.
- Periodic "deep dives" on selected cases or themes (for example, employment claims trend, regulatory investigations, a particular product or geography).

Boards benefit from concise, visual summaries – supported by appendices that can be explored in more detail outside the main meeting where necessary.

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7. Step 5 – Use the portfolio view to drive strategy and control improvements

7.1 Prioritising disputes and settlement strategy

A portfolio view of litigation risk enables CFOs and GCs to:

- Identify cases where early settlement would materially reduce risk or uncertainty.
- Distinguish between “must win” cases (because of precedent or regulatory implications) and those where a commercial resolution may be preferable.
- Allocate legal budgets and management time to matters with the greatest potential impact on enterprise value.

This supports more deliberate decisions on when to pursue aggressive litigation strategies, when to seek mediation or arbitration, and when to accept that a managed settlement is the better outcome.

7.2 Feedback into contracts, controls and culture

Litigation risk assessment should not be a static exercise. Thematic analysis of the portfolio can highlight:

- Repeated issues in particular contracts or counterparties (for example, ambiguous clauses, unenforceable terms, inconsistent implementation).
- Control failures or governance weaknesses that recur across multiple matters.
- Cultural or incentive-related drivers (for example, sales practices, product design, delegation and oversight).

Those themes should feed into:

- Contract review and template improvement.
- Board-level governance and policy changes.
- Training and communication for front-line teams.
- Investment decisions about compliance, systems and monitoring.

In this way, the litigation risk framework supports broader governance, risk and ESG agendas rather than existing in isolation.

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8. Practical questions for your next audit committee meeting

Audit committees, CFOs and GCs may find it useful to structure their next discussion around litigation risk using questions such as:

Do we have a single, coherent inventory of all significant litigation, investigations and threatened claims?

Are probability and impact assessed using consistent definitions across the portfolio?

How are litigation risk assessments linked to provisions, disclosures and scenario analysis in our financial reporting?

What are the top five disputes or investigations that could change our risk profile in the next 12–24 months?

What themes emerge from our portfolio (for example, contract types, jurisdictions, products, behaviours), and how are we addressing them?

Is responsibility for litigation risk clearly allocated between GC, CFO, the audit committee and the board, and is our reporting cadence fit for purpose?

Where could independent external review of our litigation portfolio, enforcement options or settlement strategies add value?

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How STA Legal helps audit committees, CFOs and General Counsel manage litigation risk

STA Legal is structured around high-value and high-volume disputes, regulatory exposure and governance-sensitive matters, with a particular focus on work where legal risk and commercial risk are tightly intertwined.

In the context of litigation risk quantification and audit committee reporting, the firm can assist by:

1. Portfolio review and risk mapping
   - Conducting independent reviews of existing litigation and investigation portfolios, including classification by probability, impact and strategic importance.
   - Stress-testing internal assessments, identifying outliers and highlighting where assumptions may be overly optimistic or pessimistic.
   - Providing board-ready dashboards and briefing papers that translate legal exposure into financial and governance language suitable for audit and risk committees.

2. Early case assessment and dispute strategy
   - Applying structured early case assessment techniques to key matters, focusing on prospects, quantum, enforcement and settlement options.
   - Advising on the selection of forum and process – court, arbitration, mediation or other ADR – in line with the organisation's wider dispute-resolution strategy.
   - Designing tiered response strategies that align litigation posture with reputational, regulatory and stakeholder considerations.

3. Governance frameworks and audit committee reporting
   - Working with boards, GCs and CFOs to define roles, escalation thresholds and reporting lines for litigation risk within the broader governance framework.
   - Drafting or refining litigation risk policies, playbooks and committee templates, including standardised structures for case summaries, risk ratings and decision points.
   - Providing training sessions or tailored board briefings on topics such as "Assessing Your Litigation Portfolio" and "Reporting Legal Risk to the Board".

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4. Enforcement, recovery and settlement execution
- Advising on judgment enforcement and asset recovery strategies to convert favourable decisions and awards into actual cash, both domestically and cross-border.
- Supporting structured settlement and exit negotiations, ensuring that legal, financial and reputational outcomes are aligned.
- Integrating enforcement prospects into the initial litigation risk assessment so that audit committees understand not just the likelihood of "winning", but the realism of recovering.

5. Feedback into contracts, controls and culture
- Reviewing and improving commercial contracts, terms of business and enforcement mechanisms in light of dispute experience, to reduce recurrence of known risks.
- Advising on governance enhancements, policy changes and training programmes where thematic issues (for example, control failures or cultural drivers) emerge from the litigation portfolio.

For audit committees, CFOs and GCs seeking to move from descriptive litigation updates to a disciplined, quantifiable framework, STA Legal can provide both the technical dispute expertise and the governance-led perspective needed to satisfy regulators, auditors and investors while protecting enterprise value.

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