The General Counsel and the Independent Auditor: A Critical Relationship

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Generally accepted auditing standards (GAAS) require auditors to plan and perform financial statement audits in order to obtain "reasonable assurance" that the financial statements are free of material misstatement.[1] In the performance of its duties, the independent auditor will commonly turn to the company's general counsel for assistance with obtaining information regarding fraud risks, possible contingent losses, legal representation letters, reports of potential illegal acts, and significant business transactions that may materially impact the company's financial statements and reporting obligations. The manner in which the general counsel approaches and navigates this information exchange can have far reaching consequences for the preservation of privilege, the success of the audit and any investigations that may arise, and the overall health of the company in avoiding market or litigation risk.

I. The Engagement Letter

The engagement letter between the company and the independent auditor is an important first step in framing the relationship. It sets out the objective and scope of the audit, the responsibilities of the auditor, and the responsibilities of management. As such, it should be crafted with an eye to addressing and averting potential issues that may arise in responding to the auditor's requests for information.

A. Follow the "Treaty"

The audit engagement letter should explicitly state that the audit is subject to and governed by the "Treaty"—that is, the AICPA Statement on Auditing Standards No. 12, *Inquiring of a Client's Lawyer Regarding Litigation, Claims and Assessments* and the American Bar Association's *Statement of Policy regarding Lawyers' Responses to Auditors' Requests for*

[1] When examining the financial report, auditors must follow auditing standards which are set by a governing body: American Institute of Certified Public Accounts (AICPA) Auditing Standards Board, Public Company Accounting Oversight Board (PCAOB), or the International Auditing and Assurance Standards Board (IAASB).

Information. Since 1975, the audit process with respect to loss contingencies has been governed by the Treaty, which was negotiated between the accounting and legal professions to minimize and reconcile the risk between waiving privilege and providing auditors with the information necessary to assess loss contingencies in connection with the preparation or examination of a client's financial statements. Since company counsel will rely on the Treaty in formulating responses for auditor inquiries, the Treaty should be identified in the engagement letter to make clear that both parties understand the context, scope, and limitations of the information being provided by counsel.

B. Understand and Address Disclosure Limitations

The engagement letter should also address disclosures and information sharing in light of privilege concerns likely to be implicated by communications with the auditor. Independent auditors frequently request copies of materials prepared for ongoing or anticipated litigation, including reports from internal investigations, legal opinions addressing potential liabilities, and/or presentations prepared for the board of directors on legal matters affecting the company. Thus, company counsel should discuss and reach an understanding with its independent auditor regarding the type and scope of information to be shared in light of the company's interest in retaining and protecting its privileged information.

1. *Attorney-Client Privilege*

The attorney-client privilege applies to those confidential communications between attorney and client that are made in order to obtain or render legal advice.[2] The privilege may be waived if the communication is voluntarily shared with a third party.[3] While the attorney-client

[2] *United States v. Mejia*, 655 F.3d 126, 132 (2d Cir. 2011).
[3] *See, e.g., Meija,* 655 F.3d at 134 ("[T]he presence of a third party counsels against finding the communication was intended to be, and actually was, kept confidential."); *In re John Doe Corp*., 675 F.2d 482, 488 (2d Cir. 1982).

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