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The General Counsel & Independent Auditor: A Critical Relationship

Can We Talk?

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Introduction[1]

The views expressed in this article are mine and mine alone. They reflect time spent as a prosecutor working against the largest international accounting firms, as a defense counsel working with those same firms, as well as defending CFOs and other executives in the accounting wars at the beginning of the new millennium, as a General Counsel for 11 years, and most recently as a member of a public company board audit committee. The article will not presume to talk about the hierarchy of GAAP but will focus on the intersection between a public company general counsel and an outside auditor. Let's start with the comfort zones for each. As a general counsel, I can provide privileged advice to the Board and management across a wide (but not unlimited) array of issues (though not in the EU it seems). As outside auditor, some states provide a limited privilege for communications with the audit client that is generally not recognized federally.

As a general counsel, I would be crossing the line to tell an independent auditor how to audit. In a nutshell, the attorney's role is a private one while the auditor serves a public role. Notwithstanding the conflicting roles, there is an overlapping responsibility to ensure appropriate, full and truthful disclosures regarding the company's finances and controls. Within these general principles, it is critical for a general counsel and the outside auditor to acknowledge their disparate but overlapping responsibilities for controls and public disclosure. These responsibilities are best carried out in an atmosphere of trust and mutual respect. Where such a relationship is impossible, a new audit partner should be considered. If the fault lies with the general counsel, Sarbanes-Oxley[2] has ensured that the outside auditors will report that to the

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[2] Sarbanes-Oxley Act of 2002, 116 Stat 745

Audit Committee of the Board of Directors in executive session and the company may be looking for a new GC.

A Typical Audit Committee Meeting of a Public Board

In December 2011, *Law 360* published an article[3] that captured the conflicting dynamics in the Audit Committee. The author posited a hypothetical question from the Committee to the General Counsel about a hotline fraud allegation involving procurement that the outside auditor was unaware of until the question. The lawyer wishes to provide minimal information as materiality and details are unknown and the lawyer may want to involve outside counsel. The auditor is concerned about any potential fraud in connection with the financial controls regardless of materiality. Auditors typically ask for open book on hotline and particularly fraud in financial controls matters. The General Counsel wants to preserve privilege – attorney client and work product. In 2002, after Sarbanes-Oxley, the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) issued, among other statements, Statement on Audit Standard (SAS) 99 which recognizes that while "it is management's responsibility to design and implement programs and controls to prevent, deter, and detect fraud," it is the auditor's obligation to attest to management's fulfillment of that responsibility. The GC can hold back information but the auditor can hold back the certification required for the quarterly/annual SEC filing. Disclosure by the GC may or may not render the information discoverable in civil litigation.

Most courts follow the notion that voluntary disclosure to a third party of material covered by the attorney-client privilege waives privilege and such a waiver may waive privilege on the subject matter.[4] Waiver of the attorney work product privilege often hinges on whether the disclosure is to an adversary.[5] A company's auditors are not adversaries. Or are they for these purposes? The courts are split. In *Medinol, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113 (S.D.N.Y. 2002), the court reasoned that there was an adversarial relationship and found waiver. Another district court judge in another case in Manhattan (*Merrill Lynch Co. v. Allegheny Energy, Inc.*,

[3] By Michael Dockterman, Edwards Wildman Palmer LLP
[4] *Weil v. Inv./Indicators, Research & Mgmt., Inc.*, 647 F.2d 18 (9th Cir. 1981)
[5] *In re Steinhardt Partners L.P.*, 9 F. 3d 230, 235 (2d Cir. 1993)

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