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WHITE-COLLAR CRIME

Collaborating with accountants

Relationship between lawyers and accountants can be critical to the success of independent investigations.

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"ACCOUNTING CONCEPTS are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases." *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961). It is no surprise that as investigations of corporate fraud continue to dominate the news, attorneys seek to work alongside forensic accounting "interpreters" during independent investigations to gain a better understanding of this foreign language of accounting. The working relationship between accountants and attorneys can be critical to the success of any investigation. The current regulatory environment has also placed even more emphasis on providing corporate clients and other stakeholders an expeditious, independent and thorough investigation.

What is becoming a staple of every investigation is addressing other stakeholders of the investigation, including the company's outside counsel, the external auditors, federal prosecutors, state attorneys general (and not just New York Attorney General Eliot Spitzer), the Securities and Exchange Commission (SEC), self-regulatory organizations such as the New York Stock Exchange and National Association of Securities Dealers, creditors, rating agencies and plaintiffs' lawyers. Parallel proceedings are becoming more prevalent and place a premium on the need to coordinate a well-executed response on behalf of the company from the investigative team of lawyers and accountants.

This article will discuss the increasing importance of developing a team approach to attorney and forensic-accountant collaborations during an independent investigation and will identify some keys to a successful joint effort. The article also will examine the mounting scrutiny investigators face regarding their independence, scope of work and timing.

Before engaging a forensic accountant to assist in an investigation, a company should give careful consideration to the independence of the accounting firm. It used to be that a law firm could use the company's usual auditors—perhaps with the forensic team walled off from the audit team—to assist in the internal investigation. No longer. Not only would such dual use of the accounting firm not conform to current best practices in our post-Enron world, it would most likely violate federal law. The consensus lesson from Enron likewise makes it unwise to have the company's primary outside law firm—particularly one that was involved in any of the matters under investigation—conduct the internal inquiry.

Sec. 201 (a) of the Sarbanes-Oxley Act of 2002 expressly prohibits any registered public accounting firm that performs an audit for a company from providing "contemporaneously with the audit, any non-audit service, including...legal services and expert services unrelated to the audit" for that same company. An audit firm may provide other nonaudit services, such as forensic accounting, provided that the client company's audit committee approves in advance. However, in order to maintain the integrity and objectivity of the investigation and to comply with Sarbanes-Oxley, an accounting firm that performed an audit for the company should not participate in an investigation of wrongdoing at that same company.

Forensic accountants

Once independence has been confirmed and the decision to engage a forensic accountant has been made, counsel must take necessary precautions to protect the privileges applicable to communications between counsel and the accountants. Communications with an accountant "made in confidence for the purpose of obtaining legal advice from the lawyer" are privileged. *United*

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States v. Kovel, 296 F.2d at 922. Given that litigation of some sort—against the SEC, the United States, a state or three, class action plaintiffs or derivative plaintiffs—is a near certainty during and after a forensic accounting investigation, the documents prepared by the accountants should be considered protected attorney work product, prepared in anticipation of litigation.

In order to best preserve any existing attorney-client privilege or work-product immunity, outside counsel rather than the company should engage the forensic accountants. Any document prepared by the forensic accountants in connection with the investigation should carry the header, "Privileged and Confidential Document Prepared at the Request of Counsel," in order to maintain confidentiality and any applicable privilege.

Outside counsel should engage the forensic accountants.

From the beginning of the collaboration, it is imperative that the accountants and the attorneys work together as a team through each phase of the investigation. As soon as practically possible, the team should determine the scope of the problem that is the focus of the investigation. Regular team meetings discussing developments in the investigation are a staple of an effective investigation. Integrated e-mail distribution lists facilitate rapid communication of developing evidence and theories to all relevant members of the combined legal-accounting team and keep everyone up to date between regularly scheduled face-to-face meetings.

Once the nature of the problem has been identified, the team should develop an action plan that clearly defines the scope and goals of the investigation and delegates responsibility. For example, the forensic accountants may be assigned responsibility for analyzing financial statements, financial documents, accounts and accounting statements; determining pecuniary loss or gain; testing the efficacy of compliance programs; and conducting a comprehensive review of electronic files. The attorneys, on the other hand, will be responsible for legal analysis, determination of individual culpability and for serving as the key point of contact with the authorities. The action plan is a fluid document subject to change as the investigation proceeds and more information is uncovered.

One recurring theme in internal investigations is that the nature of the investigation evolves as it proceeds. It is the rare investigation that does not present major surprises along the way. The investigating team has to balance the need for focus and efficiency with the need for acute peripheral vision and resulting flexibility. The engagement letter between the investigating lawyers and their client—usually the company, or the audit committee or a special committee of the board—can and should list the primary areas of inquiry, but also should make clear that the investigation will go wherever the evidence leads. Otherwise, an investigation of restricted scope will garner little credibility with the many audiences who view the product of the investigation.

Document collection and review is a critical and often time-consuming part of any internal investigation. The forensic accountant typically plays an integral part in this process by interacting with the company's information technology professionals to gain a full understanding of the company's computer network, including servers, remote access capabilities, retention policies and storage capacities.

The preparation of a memorandum by the accountants detailing the nature of the search and the protocols used in the search is an invaluable tool if, and when, a government investigation begins, because the memorandum provides a road map of the search scope. It is also a wise defensive move to keep meticulous records of the document search and retention, given the prevalence of investigations of the investigation, the government's aggressive prosecution of obstruction of justice and the broadly worded obstruction prohibition (18 U.S.C. 1519) added by Sarbanes-Oxley.

Employee interviews

Employee interviews serve as one of the most effective information-gathering devices in the internal investigation and usually form the core of the investigation. The information gathered from the document review is used to prepare for employee interviews. Counsel and accountants should determine which employees need to be interviewed and whether to begin by interviewing lower-level employees and then work through to senior managers or vice versa.

Often it is appropriate to start with the employees who were most centrally involved in the conduct under investigation: e.g., the chief financial officer, the controller and the accounts receivable supervisor who made key adjustments to revenue at the end of seven successive quarters, with the intention of returning to these same individuals near the end of the investigation. The collaborative effort should continue with the preparation of an outline for each employee to be interviewed, covering the items identified in the action plan and developed

during document review.

The accountants should take the lead in preparing outlines for employees who are closely involved with the company's accounting processes, while the lawyers can focus on remaining employees and the directors and top officers. The interview outlines drafted by the accountants should be edited by the lawyers, and vice versa. At least one accountant and one lawyer should be present for every interview, with the lawyer taking the lead on questioning, except when the accounting issues are arcane. The accountants should also review and edit the interview memoranda summarizing the interview. The lawyers generally, but not always, draft such memoranda.

In addition to conducting formal interviews, accountants can work closely with company accounting personnel to develop an understanding of the accounting procedures at the company. It is not unusual for forensic accountants to establish and maintain a constant presence at the company's offices during an investigation to learn the nature of the operations firsthand. Often counsel for the investigation, counsel for the outside auditors and counsel for the company's accountants can develop guidelines that will permit open communication among the company's accountants, the forensic accountants and members of the audit team, but stop short of a formal interview of a company accountant or outside auditor.

Written reports

If the client decides that it would like a written report summarizing the findings of the investigation, the lawyers and accountants will again need to work closely together to draft the report in a timely, concise and coherent manner. The team should prepare an outline of the report in the early stages of the investigation in order to give further structure and definition to the investigation. The report should contain a description of the circumstances giving rise to the investigation and the scope of the investigation, the identities of the persons interviewed, the sources of documents, an executive summary, a discussion of the background facts if necessary, an analysis of the accounting controls and corporate governance, a summary of individual conduct and culpability and remedial measures and recommendations. From the start, the accountants should take the lead in drafting specific sections that focus on accounting issues.

Investigative reports typically must cover a wide range of issues and evidence. They must be prepared on a breakneck schedule. Given these exigencies, it usually makes sense to assign various chapters of the report to separate authors. It often works well to have one lawyer and one accountant bear joint responsibility for drafting a particular chapter of the report. If a particular chapter or part of a chapter delves deeply into accounting data or literature, then the accountant should take the laboring oar. Counsel and the accountants should both play a part in any communication with the client, stakeholders and governmental agencies. Regular updates regarding the status of the investigation, the names of employees to be interviewed and who have been interviewed, preliminary findings and other matters relating to the scope of the investigation can be effectively communicated by the joint lawyer-accountant team.

While the lawyer should serve as the primary contact with the government, the lead forensic accountant should be a regular participant in meetings with the government, especially to address any accounting issues that may arise during meetings.

Preserving the privilege

The company will face enormous pressure to disclose the substance of the investigation to third parties, particularly government agencies. Protecting and perhaps waiving the attorney-client privilege and work-product immunity are critical issues that can arise in any accounting investigation. The Department of Justice and SEC each have formal policies that strongly encourage companies to cooperate with governmental investigations, including the waiving of privilege by providing investigative reports and even interview notes to authorities. The Department of Justice says that it will consider a company's "willingness to cooperate in investigation of its agents, including if necessary, the waiver of the corporate attorney-client and work product protection," when deciding whether to bring criminal charges. See www.usdoj.gov/dag/cftf/corporate_guidelines.htm.

Coordination of the efforts of the investigative team is critical to the overall success of the investigation. One cannot overestimate the importance of the attorneys and forensic accountants working closely together on interviews, strategy and findings. It is through this collaboration that the mysteries of the foreign language of accounting can be interpreted and understood. NLJ