



ACC'S CLO ThinkTank Series 2006

“LAW DEPARTMENT’S ROLE IN FINANCIAL COMPLIANCE & THE RELATIONSHIPS WITH AUDITORS”

Hosted by Don Liu, CLO of Toll Brothers, Inc.

March 24, 2006

10:00 a.m. – 2:00 p.m.

The Ritz Carlton Philadelphia- Philadelphia PA

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Participants’ Briefing Materials

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SUMMARY/ OUTLINE OF DISCUSSION TOPICS

LAW DEPARTMENT'S ROLE IN FINANCIAL COMPLIANCE & THE RELATIONSHIP WITH AUDITORS

The following outline is intended to provide a short overview of some of the issues at the heart of this discussion topic. There may be other issues we've not identified or perspectives on the identified issues that are not adequately represented in the outline: you should feel free to raise these additional thoughts, as you like. *The outline is merely intended as a starting point to help you identify discussion topics and tee up your conversation.*

A. Organizational Structure: Links & Reporting Relationships Between Internal Audit¹, the Audit Committee and the Law Department

1. Organizational reporting models

- Internal Audit Separate from the Law Department: Is Internal Audit a separate function without any organizational reporting relationship to the Law Department? Are the head of Internal Audit and the CLO considered “peers”? To whom does the head of Internal Audit report?
- Internal Audit Reports Organizationally to the Law Department: Does Internal Audit report into the Law Department (head of internal audit reports to CLO or to a Direct report of the CLO) on solid or dotted-line basis?
- Internal Audit Reports Organizationally to Audit Committee: Does Internal Audit report organizationally on a solid or dotted-line basis to the Audit Committee? Is this the sole organizational reporting structure or are there dual reporting lines where Internal Audit also reports to a functional department or officer of the company?
- Multiple Reporting: Does Internal Audit report organizationally to multiple departments or functions (dotted or solid-line)?
- Separate Compliance-Related Functions: Does your company have separate organizational functions for Compliance, Internal Audit, Security, etc.? If so, to who do the leaders of these functions report?

¹ We have chosen the term “internal audit” to describe the corporate function that assesses and reports on corporate compliance with any number of state and federal legal, accounting, and internal governance requirements. Companies may title this function differently, using such terms as “internal controls,” “corporate ethics and compliance,” etc. Use of “internal audit” to convey all of these corporate equivalents is a shorthand convenience and hopefully won’t distract attention from the larger matter.

- Other Models; Recent Changes: Other models? Has your company's organizational reporting structure changed recently (and what was the rationale for making the change)?

2. **Audit Committee**

- Role in Financial Compliance: Is your Board's Audit Committee responsible for oversight of the company's financial compliance? What are the key Audit Committee responsibilities as defined in the committee's charter? How has committee composition evolved over the past 5 years? How often does the committee meet? Does your company's program for reporting concerns provide employees with a 'direct line' to the Audit Committee to report concerns relating to financial matters or fraud?
- 'Financial Experts': How many are on your Audit Committee? How hard has it been to find them? What types (if any) of protections are they seeking in order to perform this role?
- Legal Staffing: Are there designated lawyers within your law department on point for supporting the Audit Committee of the Board? Do you as CLO (or certain lawyers within your department) regularly participate in Audit Committee meetings? Does the Audit Committee regularly invite outside counsel to attend its meetings? Does the committee have its own outside counsel? If so, how are the roles of the in-house and outside lawyers defined or coordinated?
- Role of In-House Lawyers; CLO: If In-House Lawyers attend Audit Committee meetings, what role do they play? Do they regularly provide reports or presentations on issues within the company or developments generally in the financial compliance area? Are you as CLO or members of your staff asked to sit in on Executive Sessions of the committee (without the CEO or CFO present)? Do in-house lawyers have a role in investigating concerns brought to the attention of the Audit Committee? Do you see trends in the evolution of the role of in-house lawyers in support of the Audit Committee?
- Outside Experts: Has your Audit Committee sought to engage outside experts to evaluate your company's financial compliance structure?
- Reports Regarding Financial Compliance Concerns or Fraud: Do the company's processes and channels for reporting concerns regarding financial compliance or controls or financial fraud include a direct reporting channel to the Audit Committee? If intake of these reports generally occurs elsewhere (e.g., either through an outside helpline service or internal helpline or ombuds channels, etc.), what is the policy and process for communicating concerns relating to financial matters or allegations of fraud to the Audit Committee? How (if at all) does the CLO or law department receive notification of any such reported concerns? What role does the Audit Committee perform in investigating such reported concerns?

- Board Committees Responsible for Compliance: Does your company have other Board Committees responsible for compliance oversight? Does that committee's responsibility include some financial compliance oversight role? What practices have you implemented to help facilitate coordination?

3. Management Compliance/Ethics Committee

- Committee Composition: Does your company have a management-composed Compliance Committee that plays a role in setting strategic compliance initiatives and policies for financial compliance and taking related actions? Who participates on the Compliance Committee?
- Role of CLO: If your company has a Compliance Committee, do you as CLO (or, as applicable, Chief Compliance Officer) participate on or advise that committee? If you do not, does someone on your staff? How (if at all) has your role changed during the past 5 years?
- Committee Charter: What are the key responsibilities of the compliance committee? Is this a relatively new committee? How often does the committee convene? Does the committee have an official charter?
- Reportable Matters; Financial Information Releases: Does the compliance committee play a role in determining which financial compliance matters need to be brought to the attention of the Board? Does the committee have a role in reviewing and/or signing off on financial information filings, securities filings, earnings releases? Does the compliance committee regularly report to the Board on financial compliance?

4. Law Department; CLO

- Scope of the Law Department's Role: What is the law department's role in connection with the company's financial compliance and internal financial controls programs? Does the law department have responsibility for running the company's financial compliance/ controls programs OR does the law department play a supporting role, have no role, or something in between?
- Role of CLO: Are you, as CLO, on point for supporting the CFO? How have your services in support of financial compliance changed during the past 5 years? Are you requested/expected to provide written internal certifications in support of financial compliance and/or the sufficiency of internal financial controls?
- Legal Staffing: How many (if any) lawyers are assigned as being on point for supporting Internal Audit? Are they embedded within Internal Audit or part of the Law Department? Are there non-lawyer professionals from the Law Department who help support Internal Audit? Are lawyers assigned as being on point for supporting the Audit Committee of the Board? Do they regularly attend the Audit Committee meetings?
- Legal Services: Do in-house lawyers write policies or help develop questionnaires or audit checklists for financial compliance? Do they

participate on the audit teams? Do they play a role in reviewing audit reports and/or financial earnings statements? What is their role in developing and implementing internal controls? What role do in-house lawyers play in identifying and determining reportable matters, supporting financial statement certifications, and identifying loss contingencies?

- Reportable Matters: What is the process for determining reportable matters? Do in-house lawyers meet periodically (quarterly, semi-annually, annually) with internal audit, the Audit Committee, external auditors to discuss potentially reportable matters or financial filings?
- Training: How are in-house lawyers staying current with changing and complex accounting rules? What programs, educational offerings or resources would be helpful to you or your in-house lawyers regarding financial compliance training? Do in-house lawyers play a role in developing or providing training to the Internal Audit team (and on what topics)?

5. **Compliance Officer/Ethics Officer**

- Positions: Does your company have a Chief Compliance Officer? A Chief Ethics Officer? Do you as CLO perform either role? What do you see as the distinction between a compliance officer and an ethics officer? What are your views on benefits and concerns of having the CLO also serve as the Chief Compliance Officer?
- Role in Financial Compliance: What roles do your Chief Compliance Officer/Chief Ethics Officer play with regard to financial compliance programs and processes? Do they have an oversight role? Do they play a role in program development?

Links to Resources:

(<http://www.acca.com/resource/v5902>)

B. **Financial Compliance & Internal Controls Processes**

1. **Policies & Channels for Reporting Financial Concerns**

- Policies: What policies are in place regarding reporting financial concerns or allegations of financial fraud? Does your company have a separate policy for these matters or is there a broad policy for reporting concerns generally? Is there an obligation/requirement OR an expectation/encouragement to report such concerns? How are the company's policies communicated to employees—through governance policies, Code of Business Conduct/Ethics, etc.? Do you have a separate Code of Conduct for finance professionals and the CEO or does a more general Code of Conduct apply to all employees?
- Channels for Reporting Concerns: What channels are available for reporting financial concerns? Is there a direct line to the Audit Committee? Is there a

direct line to the CLO? Is there an opportunity to submit a confidential or anonymous report? Are there different mechanisms in place for different parts of the company or is your program implemented globally? For global companies, are recent decisions by regulatory authorities in certain European countries presenting challenges with respect to how your company implements these policies globally?

- Process for Investigating Concerns re Financial Matters/Allegations of Fraud: What is the internal process for receiving concerns and taking steps to investigate reports alleging financial misconduct or fraud? What are the roles of Internal Audit, the Audit Committee, the law department, and any other key players? Do you as CLO receive an early report of any such matters? In general, what organizational group (e.g., Audit Committee, Internal Audit, Law Department, Outside Lawyers, other...) would take the lead in investigating a reported concern regarding a financial matter or financial fraud? What is the role of the law department?
- Privilege: Is privilege protection generally a consideration in determining the process for conducting internal investigations of these matters? If so, what types of practices does your company implement to seek and maintain privilege protections? What role does the law department play? Do lawyers generally take the lead or play a supporting role? What criteria are considered in determining whether to involve outside counsel? If outside counsel is engaged, are there practices regarding use of 'independent counsel'? Do you maintain a 'list' of independent counsel to call upon if need be?
- Law Department Up-the-Ladder Reporting/Sarbox 307: Does your law department have an up-the-ladder reporting policy? Does implementing the policy include having lawyers provide periodic written certifications? Do you consider the scope of your law department's policy to be broader than Sarbox 307? Does the policy apply to all lawyers within your department or to lawyers with certain specified roles? What type of training have you provided lawyers with regard to their responsibilities under this policy? Have you designated 'supervisory attorneys'? What have been the key challenges for you as CLO in connection with implementing and enforcing these policies within your law department? How (if at all) have these law department obligations been communicated to your business clients and do you think there has been an impact on the candor of conversations and the matters brought to the attention of lawyers?

2. Processes for Financial Filings, Earnings Releases & Other Financial Communications

- Roles: What part of your company's organization is on point for preparing information in connection with these filings or communications? What are the respective roles of Internal Audit, Accounting/Treasurer, Audit Committee, Law Department, CEO, others?

- Process for Financial Filings: For financial filings with regulatory authorities, what internal processes and sign-offs or certifications are required? What is the role of the law department in supporting these filings? Do you and/or lawyers within your law department meet periodically (e.g., quarterly, semi-annually, annually) with members of the internal audit team and/or the Audit Committee to provide input on these filings? What is the scope of input requested of and provided by lawyers?
- Process for Financial Communications: What role do in-house lawyers play in reviewing earnings releases or other financial communications? Are in-house lawyers asked to provide a sign-off on these communications? What guidelines are in place for developing these communications?
- Internal Certifications: Do you as CLO (or others within your law department) provide supporting certifications to your CEO or CFO on financial or regulatory filings? In order to provide your certification, do you ask others within your law department to provide sub-certifications? Are these certifications provided by lawyers generally verbal or in writing? If you do not provide certifications, have they been requested of you and how have you successfully explained that they are not necessary? If you do provide such certifications, what types of qualifiers (if any) do you include?
- Process & Timing Issues: What types of tools, databases, software does your company implement in support of its financial controls processes? Who is on point for managing these tools? How do you coordinate internally to be able to timely report matters that have a short reporting fuse?

3. Internal Matters & Controls

- Information Requests: What types of information does Internal Audit request in connection with its processes? Does Internal Audit request documents such as Board or Audit Committee minutes, privileged documents relating to current, pending, possible litigation or enforcement, other? What types of approaches has your law department taken in providing to Internal Audit information that may be privileged (e.g., Do you have face-to-face meetings where you discuss the facts but do not turn over documents? Do you hand the documents over? Do you create a fact summary?) Does Internal Audit ask for different information from in-house lawyers than from outside lawyers?
- Accruals, Loss Contingencies Relating to Legal Matters: What processes are in place to account for these? Do you or members of your staff meet periodically (if so, how often?) with your company's financial personnel to discuss pending or anticipated litigation or regulatory matters and help inform their decisions on accruals and contingencies? What limits (if any) do you place on your guidance to them in these areas? What training on scope of responsibilities do you provide to lawyers within your law department who communicate with finance on these issues?

- Internal Audits: What role does the law department play in connection with planning and implementing internal audits? Does the law department help develop audit protocols? Have you noticed any trends suggesting an expansion of the scope of Internal Audit's inquiries (e.g., beyond matters traditionally considered financial)? Do in-house lawyers participate on audit teams? Are internal audits performed as privileged? Do in-house lawyers review draft audit reports? Do in-house lawyers have a role in delivering final internal audit results and/or assisting with response to issues identified in audits?
- Privilege Considerations: How do privilege considerations and potential third party suits impact communications with Internal Audit or finance personnel in this area? Have you experienced an increase in requests for privileged information? If so, what strategies have you implemented to help maintain privilege? What do you see as the key challenges in this area? What types of tools or resources would be helpful to you in responding to these requests?

Links to Resources:

(<http://www.acca.com/resource/v5902>)

(<http://www.acca.com/resource/v6527>)

(<http://acc.com/resource/v4853>)

(<http://acc.com/resource/v6328>)

C. Relationships with Outside Auditors

- Engagement Letters: How have auditor engagement letters changed in recent years? Have you received letters asking for advance waivers of attorney-client privilege? If so, how have you addressed these requests? Who manages the auditor engagement process for your company? What provisions within these letters do you find to be most problematic?
- Auditor Independence: How have requirements regarding auditor independence impacted practices and services for your company? Have you/has your law department been involved in helping to develop a pre-approval strategy for the Audit Committee to facilitate its role in selecting and approving independent auditors? What are the key components of this strategy? If you have a policy, does it include the terms of engagement and fee thresholds for various types of services? Does it have a term? How does the policy address services to affiliates or subsidiaries? Have you had to help navigate a potential auditor independence issue? How were you able to successfully resolve the issue?
- Audit Committee Meetings: Do outside auditors regularly attend Audit Committee meetings? If not regularly, for what types of circumstances do they attend? Do outside auditors want their lawyers to attend your company's Audit Committee meetings?

- Auditor Inquiries/Legal Guideposts: Among the ‘legal guideposts’ for responding to auditor requests for information are:
 - ABA-AICPA Treaty (AICPA Statement on Auditing Standards Number 12- “SAS 12” and ABA Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information) – is this even still ‘alive’?
 - PCAOB Rules governing the conduct of auditors, passed pursuant to authority/charter created by Sarbanes-Oxley
 - SEC Regulation S-K, Item 103 “Legal Proceedings;” Rule 13b2-2
 - ABA Model Rules of Professional Conduct- Rule 1.6 (Confidentiality of Information)
 - Sarbanes-Oxley Act – general governance proscriptions
 - Exchange rules and shareholder guidance: NYSE, NASDAQ, ISS, Corporate Library, CalPERS, TIAA-CREF, etc. all issue guidance on appropriate standards/benchmarks for well-governed financial compliance
 - USSC Chapter 8: The Sentencing Guidelines create a framework for considering when a company’s compliance efforts have been reasonable, meaningful and effective
- Responding to Auditor Requests; Method & Scope: In responding to requests, do you generally opt to respond in writing? Do you generally limit your response to ‘material’ items and how do you define ‘material’? What about undertakings to periodically update your response—do you include these? Are updates or ‘bring-downs’ (if any) generally provided verbally or in writing, and how often are these requested? Do you or lawyers within your law department meet face-to-face or have periodic telephone conversations with outside auditors? Have you used strategies to provide information in a way other than by providing a written certification or letter—if so, what?
- Adequacy of Reserves; Material Unasserted Claims: What types of practices do you implement regarding information on the adequacy of financial reserves and on the existence of material unasserted claims?
- Outside Counsel Responses: What role does outside counsel play in responding to these requests? Do outside auditors require different information and in different formats (e.g., writing vs. verbal) from in-house vs. outside lawyers? Do outside lawyers meet face-to-face with your company’s independent auditors?
- Privilege Considerations: Have outside auditors requested access to privileged documents? Have they threatened to withhold providing their audit letter if these documents are not provided? What strategies have you implemented in lieu of providing privileged documents? If you have provided privileged documents, has this resulted in/are you concerned about negative



impacts with regard to third party litigation? Are there tools or resources that would be helpful to you in this area?

- ACC Actions: ACC's Board of Directors has endorsed a Corporate Counsel Consortium proposal to help resolve the auditor issue (See www.acca.com/protected/article/attyclient/debate.pdf). In addition, ACC has recently filed an *amicus* brief in a case before the Texas Supreme Court on the issue of reliability of the accountant-client privilege and related attorney-client privileges. ACC is also spearheading in cooperation with other business groups initiatives advocating for preservation of attorney-client privilege; these actions include filings and testimony before U.S. Congress, the U.S. Sentencing Commission, and meetings with the U.S. Department of Justice and Securities and Exchange Commission.

Links to Resources:

(<http://acc.com/resource/v6592>)

(<http://acc.com/resource/v5829>)

(<http://acc.com/resource/v1282>)

(<http://acc.com/resource/v6903>)

(<http://acc.com/resource/v6292>)

(<http://www.acca.com/public/amicus/txamicus.pdf>)

(<http://www.acca.com/public/article/attyclient/debate.pdf>)