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Closing the Auditor Loophole: Towards a More Perfect Work-Product Waiver Doctrine

Evan Mulbry
University of Michigan Law School

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CLOSING THE AUDITOR LOOPHOLE: TOWARDS A MORE PERFECT WORK-PRODUCT WAIVER DOCTRINE

*Evan Mulbry**

ABSTRACT

The Supreme Court created strong protections for the attorney's thought processes and analysis in Hickman v. Taylor. However, the Court in Arthur Young & Co. created a loophole enabling opposing lawyers to access the lawyer's thought processes and legal strategies. This loophole was created when the Court allowed discovery of an auditor's tax workpapers, and lower courts then interpreted this decision to imply that disclosing information to the outside auditor constitutes a waiver of attorney work-product protections. This loophole can be corrected through a Congressional statute that impacts the Federal Rules of Evidence, which would protect communications between outside auditors and their clients for legally required audits. If Congress fails to act, then courts should hold that disclosure of documents to outside auditors as part of a Securities and Exchange Commission required audit does not waive attorney work-product protections.

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INTRODUCTION

In the public eye, accountants are often portrayed as hunched over a calculator and wearing a green visor.[1] They have been described as "the sort of people with whom you would not want to be caught in [the] corner of the room at a cocktail party."[2] Despite these negative portrayals, accountants are vital to our securities markets. Accountants provide the public with the vital information they need to make investing decisions.[3]

When a company makes a public offering, it is required to have an independent accounting firm audit its financial statements. That firm provides an opinion on whether the financial statements are fairly stated in accordance with Generally Accepted Accounting Principles ("GAAP").[4] Securities and Exchange Commission ("SEC") regulations require public companies be audited

1. *See* Melissa J. Sawyer, *Accountant Myths & Stereotypes – The Truth About Accountants*, BENTLEY CAREEREDGE BLOG (July 9, 2019), https://careeredge.bentley.edu/blog/2019/07/09/accountant-myths-stereotypes-the-truth-about-accountants/.

2. Adam C. Pritchard, *The Irrational Auditor and Irrational Liability*, 10 LEWIS & CLARK L. REV. 20, 20 (2006).

3. Dan Woods, *The Role of Accounting in Business and Why It's Important*, PDR-CPAS (Feb. 19, 2019), https://www.pdr-cpa.com/knowledge-center/blog/role-of-accounting-in-business.

4. Generally Accepted Accounting Principles are the regulations that govern how economic transactions must be accounted for by companies in the United States. *Frequently Asked Questions About the AICPA*, AICPA.ORG, https://www.aicpa.org/about/faqs.html (last visited Sept. 2, 2020).

once per year in addition to issuing quarterly reports.[5] Private companies must also periodically obtain a financial statement audit to conform with shareholder requests and banking requirements.[6] In these financial statement audits, companies assess the strengths, weaknesses, and potential outcomes of pending litigation. However, litigation opponents can use these audits to access the legal strategy of an opposing attorney; disclosure as part of the financial statement audit may waive attorney work-product protections. This access may contradict the protections the Supreme Court afforded attorney work-product in *Hickman v. Taylor*.[7]

Litigation opponents can circumvent attorney work-product protections because the Supreme Court allows broad discovery of audit workpapers. In *United States v. Arthur Young & Co.*, the Supreme Court held audit workpapers are discoverable by the Internal Revenue Service ("IRS"), even when the firm's accountants opine on the company's potential success on a tax position.[8] The Court reasoned auditors have a duty to the public when certifying public reports, [9] and rejected the argument that firms will respond by withholding information from auditors.[10]

This holding puts companies in a difficult position. On one hand, failure to disclose case-related information to an auditor may lead to a disclaimer of opinion on the company's financial statements.[11] A disclaimer of opinion is where the auditor is either unable or unwilling to express an opinion on the accuracy of the company's financial statements.[12] On the other hand, disclosure may lead to a waiver of attorney work-product protections.[13] Therefore, companies must either disclose information to auditors, and potentially waive the protections or withhold information and receive an unfavorable accounting opinion.

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5. Securities and Exchange Commission, Financial Reporting Manual – Topic 4 (June 30, 2009), https://www.sec.gov/corpfin/cf-manual/topic-4.

6. *See Private Company Audits*, ASSURANCEDIMENSIONS.COM, https://assurancedimensions.com/services/private-company-audits/#:~:text=Many%20private%20business%20are%20required,the%20business%20(due%20diligence) (last visited Oct. 25, 2020).

7. *See* Hickman v. Taylor, 329 U.S. 495, 509 (1947) ("In our opinion, neither Rule 26 nor any other rule dealing with discovery contemplates production [of information gathered or prepared in anticipation of litigation].").

8. *Id.*

9. United States v. Arthur Young & Co., 465 U.S. 805, 818 (1984) ("This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.").

10. *Id.* at 817.

11. *Id.* at 818.

12. *Disclaimer of Opinion Definition*, ACCOUNTINGTOOLS.COM (DEC. 27, 2021), https://www.accountingtools.com/articles/2018/2/16/disclaimer-of-opinion#:~:text=A%20disclaimer%20of%20opinion%20is,financial%20statements%20of%20a%20client.&text=For%20example%2C%20the%20auditor%20may,complete%20all%20planned%20audit%20procedures. (last visited Oct. 26, 2020).

13. *See generally* First Horizon Nat'l Corp. v. Hous. Cas. Co., No. 2:15-cv-2235-SHL-dkv, 2016 WL 5867268 (W.D. Tenn. Oct. 5, 2016).

Subsequent to *Arthur Young & Co.*, accounting research shows clients responded by withholding information from their auditors.[14] In other words, where they can withhold bad information, they will.[15] In light of this research and recent cases that continue to treat disclosure as a waiver of attorney work-product protections, it may be useful to revisit the reasoning of *Arthur Young & Co* and the problems the broad ruling created.

To address the subsequent issues, Congress should create a narrow privilege protecting communications between the auditor and client during a SEC-required financial statement audit. Recent accounting frauds should raise concerns in Washington that companies are not accurately portraying their financial condition to investors.[16] The fact that sophisticated blue chip companies continue to materially misstate their financial condition demonstrates that a privilege is necessary to incentivize companies to share information with their auditors, so auditors have the data they need to prevent this harm to investors. This proposition is further supported by accounting research discussed below, which has finally accumulated enough evidence to demonstrate change is needed.[17] Without such a protection, companies will continue to withhold information from auditors resulting in financial misstatements that will lead to more losses for everyday investors.

More broadly, this rule change would begin to address issues in the attorney work-product waiver doctrine. The subject of attorney work-product waiver has received little attention from writers.[18] As described below, there is currently a circuit split on which test applies to work-product waiver.[19] Some of these tests allow for broad waiver of work-product protections,[20] which undermine the doctrine because the risk of disclosure leads lawyers to forgo recording their legal strategies. Therefore, addressing accountant-related attorney work-product waiver would be a first step towards aligning work-product waiver with the Court's intent in *Hickman*, which was to incentivize lawyers to document

14. Matthew Anderson et al., *Internal Revenue Service Access to Tax Accrual Workpapers: A Laboratory Investigation,* 65 ACCT. REV. 857, 858 (1990).

15. Dichu Bao et al., *Do Managers Disclose or Withhold Bad News? Evidence from Short Interest*, 94 ACCT. REV. 1, 1 (2019).

16. *E.g.* Dave Michaels & Thomas Gryta, *GE to Pay $200 Million to Settle SEC Accounting Probe* WALL ST. J. (Dec. 9, 2020), https://www.wsj.com/articles/ge-to-pay-200-million-to-settle-sec-accounting-probe-11607553764#:~:text=The%20SEC%20and%20the%20Justice,business%20and%20its%20power%20business.&text=GE's%20stock%20tumbled%20in%202017,%24200%20billion%20in%20market%20value.

17. *See* discussion *infra* Part II.

18. Kenneth W. Graham, Jr. & Ann Murphy, *Policy of the Rejected Rule, in* ARTHUR R. MILLER & CHARLES ALAN WRIGHT, FEDERAL PRACTICE AND PROCEDURE § 5722 (2020).

19. *See* discussion *infra* Part I.B.

20. Blattman v. Scaramellino, 891 F.3d 1, 5 (1st Cir. 2018) (discussing that in order for waiver to take place, the disclosing party must act in a way inconsistent with keeping the information from an adversary).

their legal analysis.[21] Until these changes are made, the auditor related attorney work-product waiver provides an avenue for parties seeking access to the opposing lawyer's legal strategy.

Part I will discuss the evolution of attorney work-product, how these protections are waived, accountant-client privilege, and the current lack of protections for auditor-client communications. Part II will analyze the repercussions of this situation, including the attorney work-product waiver's impairment of the *Hickman* doctrine and the quality of information provided to the financial markets. Part III will argue for a statute that extends privilege to include discussions between counsel and the accountant during audits required by SEC regulations. Part III will also discuss that without this statute, the current problem can be partially addressed by courts holding disclosure to an outside auditor does not waive work-product protections. Part IV will summarize and conclude the paper.

PART I: BACKGROUND

Understanding the work-product doctrine will illustrate how *Arthur Young & Co.* impaired one of its central tenets. This section will first discuss the evolution of the attorney work-product doctrine, its different tests, and how its protections are not absolute. Next it will discuss the current doctrine of attorney work-product waiver and the different tests circuits apply. Afterward, it will discuss the evolution of accountant-client privilege and the difference between federal and state protections of the privilege. Finally, it will explain the different ways courts interpret *Arthur Young & Co.*

Section A: Evolution of the General Work-Product Doctrine

The work-product doctrine began with the famous holding of *Hickman v. Taylor*, where the Supreme Court announced a lawyer's materials prepared in litigation should be protected from disclosure to the opposing party.[22] The work-product doctrine allows an attorney to prepare her case without fear of intrusion from the opposing party.[23] The Court feared allowing an opponent access to the lawyer's thought processes would incentivize lawyers to refrain from documenting critical aspects of a case, and therefore hurt the legal profession.[24] After *Hickman,* Congress adopted Federal Rule of Civil Procedure 26(b)(3) to protect "documents and other tangible things" from discovery.[25] However, this rule does not address what circumstances are necessary for work-product pro-

21. *See* Hickman v. Taylor, 329 U.S. 495, 511 (1947) ("Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten.").

22. *Id.* at 514.

23. *Id.*

24. *Id.* at 511.

25. FED. R. CIV. P. 26(b)(3).

tections to apply. As a result, Courts adopted various tests to determine when the protection attaches.[26]

Modern courts rely on a summary, written by a group of law professors,[27] dividing attorney work-product into different classifications.[28] In their summary, they differentiate between ordinary work-product and opinion work-product.[29] Ordinary or fact work-product consists of "documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative."[30] Ordinary work-product is generally subject to protections from discovery by the opposing party but can be overcome upon a showing of "substantial need" and "undue hardship."[31] In contrast, opinion work-product is narrowly confined to the attorney's legal analysis.[32] It encompasses "mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation."[33]

Because it reflects the attorney's analysis of her client's legal position, courts provide a heightened standard of protection for opinion attorney work-product as compared to ordinary or fact attorney work-product.[34] The ruling in *Arthur Young, & Co.* and its progeny undermine this heightened standard of protection. The result allows opposing parties easy access to the lawyer's thought processes, rather than forcing them to meet the heightened standards typically afforded opinion attorney work-product.[35]

Section B: Evolution of Attorney Work-Product Waiver

Neither ordinary nor opinion attorney work-product protections are always absolute. Each can be waived if not exercised properly.[36] Circuits apply different

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26. *See, e.g.*, United States v. Deloitte LLP, 610 F.3d 129, 137 (D.C. Cir. 2010) (noting the Court applies the "because of" test in determining whether a document is protected by the attorney work-product doctrine); United States v. El Paso Co., 682 F.2d 530, 542 (5th Cir. 1982) (phrasing the test as "[L]itigation need not be imminent . . . as long as the primary motivating purpose behind the creation of the document was to aid in possible future litigation.") (internal quotations omitted); United States v. Davis, 636 F.2d 1028, 1040 (5th Cir. 1981).

27. Jeff A. Anderson, et al., *The Work Product Doctrine*, 68 CORNELL L. REV. 760, 790 (1983).

28. *See, e.g.,* Nadeau v. Shipman, No. 1:17-cv-074, 2019 WL 188419, at *2 (D.N.D. Jan. 14, 2019); *In re* Aggrenox Antitrust Litig., No. 3:14-md-02516 (SRU), 2017 WL 5885664, at *12 (D. Conn. Nov. 29, 2017); United States v. Frostman, 221 F. Supp. 3d 718, 726 n.3 (E.D. Va. 2016); Washington v. Follin, No.: 4:14-cv-00416-RBH-KDW, 2016 WL 1614166, at *14 n.37 (D.S.C. Apr. 22, 2016) (describing the work-product article as an "excellent discussion").

29. *Id.* at 783–84.

30. *Id.* at 792 (quoting Fed. R. Civ. P. 26(b)(3)); FED. R. CIV. P. 26(b)(3).

31. *Id.* at 798 (quoting Fed. R. Civ. P. 26(b)(3)).

32. *See id.* at 817–19.

33. *Id.* at 817 (quoting Fed. R. Civ. P. 26(b)(3)).

34. *Id.*

35. *See* Discussion Part II, *infra*.

36. *See* United States v. Nobles, 422 U.S. 225, 239 (1975) ("The privilege derived from the work-product doctrine is not absolute. Like other qualified privileges, it may be waived.").

tests to determine whether a party waived attorney work-product protections when disclosing protected information.[37] For example, the Fourth Circuit uses, among others, the "common interests" test which looks at whether the disclosing party has common interests with the recipient.[38] The First Circuit analyzes, among other things, whether the party disclosed the attorney work-product protected documents in a manner "inconsistent with keeping [them] from an adversary."[39] The Ninth Circuit's analysis has taken a broader approach and has looked at whether the disclosure substantially increased the likelihood an adversary would gain access.[40] These tests create a confusing situation for lawyers deciding whether work-product protections have been waived.

Compounding this confusion is the dearth of scholarly writing on work-product waiver.[41] An overly broad work-product waiver impacts a party's behavior because lawyers respond by failing to record elements of the case due to waiver concerns.[42] This incentive to refrain from documentation undermines the attorney work-product doctrine because incentivizing lawyers to document their legal strategy was a central tenet motivating the doctrine's creation.[43] Due to minimal scholarship in this area, it is difficult to place individual attorney work-product waiver rulings in context to determine whether courts are developing a coherent doctrine. This backdrop combined with the lack of protections governing interactions between auditor and client adds another layer of complexity to this situation. However, an in-depth discussion of attorney work-product waiver exceeds the scope of this paper.

Section C: How Accountants Access Privileged Materials

Accountants in the securities industry may not garner significant public attention, but they play a vital role in ensuring accurate financial information is

37. *Compare* Wells v. Liddy, 37 F. App'x 53, 65 (4th Cir. 2002) (holding that making "testimonial use" of protected materials waives work-product protections), *with* Blattman v. Scaramellino, 891 F.3d 1, 5 (1st Cir. 2018) (discussing that in order for waiver to be affected, the disclosing party must act in a way inconsistent with keeping the information from an adversary).

38. *See In re* Doe, 662 F.2d 1073, 1081 (4th Cir. 1981) ("Disclosure to a person with an interest common to that of the attorney or the client normally is not inconsistent with an intent to invoke the work-product doctrine's protection and would not amount to such a waiver.").

39. *Blattman*, 891 F.3d at 5 (quoting United States v. Mass. Inst. of Tech,, 129 F.3d 681, 687 (1st Cir. 1997).

40. United States v. Sanmina Corp., 968 F.3d 1107, 1121 (9th Cir. 2020) ("Thus, consistent with our sister circuits as well as precedent on the unique purposes for the work-product doctrine, we hold that disclosure of work product to a third party does not waive the protection unless such disclosure is made to an adversary in litigation or 'has substantially increased the opportunities for potential adversaries to obtain the information.'").

41. *See* Graham & Murphy, *supra* note 18.

42. *See* Richard L. Marcus, *The Perils of Privilege: Waiver and the Litigator*, 84 MICH. L. REV. 1605, 1606 (1986).

43. *See* Hickman v. Taylor, 329 U.S. 495, 511 (1947) ("Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten.").

communicated to the public. Accountants auditing publicly traded companies must determine whether company management presented "in all material[44] respects, [the] financial position, results of operations, and…cash flows in conformity with generally accepted accounting principles."[45]

Auditors accomplish this objective by performing audit procedures to become reasonably sure a particular account is free of material misstatement.[46] Usually, the auditor will select a sample of transactions to evaluate as part of the audit.[47] When reviewing transactions, the auditor will work with management to assess, among other things, whether the basis for management's valuation is reasonable (i.e. what assumptions are behind the valuation).[48]

Under SEC regulations, auditors are required to perform this corporate audit yearly and obtain a lesser level of assurance[49] on a quarterly basis.[50] Two accounts of particular concern for lawyers are the Deferred Taxes Account[51] and the Contingencies Account,[52] because auditor review of these accounts requires access to attorney workpapers in the form of attorney memos and tax position assessments. As a result of requesting this information, the associated audit workpapers[53] often reflect a corporation's legal strategy.

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44. A determination of financial statement materiality is based on whether the information impacts investors' decision-making. *See In re* Greene, 96 B.R. 279 (Bankr. 9th Cir. 1989) ("A [financial] statement can be materially false if it includes information which is 'substantially inaccurate' and is of the type that would affect the creditor's decision making process.").

45. PUB. CO. ACCT. OVERSIGHT BD., AUDITING STANDARDS NO. 1001: RESPONSIBILITIES AND FUNCTIONS OF THE INDEPENDENT AUDITOR § .01 (2002), https://pcaobus.org/oversight/standards/auditing-standards/details/AS1001.

46. *See Audit Procedures Definition*, ACCOUNTINGTOOLS.COM, https://www.accountingtools.com/articles/audit-procedures.html (last visited Oct. 25, 2020).

47. PUB. CO. ACCT. OVERSIGHT BD., AUDITING STANDARDS NO. 2315: AUDIT SAMPLING § .01 (2014), https://pcaobus.org/oversight/standards/auditing-standards/details/AS2315.

48. *See id.* § .25–.30.

49. *See* PRICEWATERHOUSECOOPERS, UNDERSTANDING FINANCIAL STATEMENT AUDITS 6, 13 (2017), https://www.pwc.com/im/en/services/Assurance/pwc-understanding-financial-statement-audit.pdf (noting that an interim review requires an accountant to review "whether anything has come to their attention that suggests the financial information is not prepared, in all material respects, in accordance with the relevant GAAP," whereas a financial statement requires the auditor to obtain "reasonable assurance about whether the financial statements are free of material misstatement").

50. *Exchange Act Reporting and Registration*, SEC. & EXCH. COMM'N (Apr. 1, 2022), https://www.sec.gov/smallbusiness/goingpublic/exchangeactreporting.

51. Deferred taxes refer to the netting of Deferred Tax Assets and Deferred Tax Liabilities. Both accounts seek to accrue future tax expense or prepayment when the income is earned, not when the tax is paid. *Accounting for Deferred Taxes*, ACCOUNTINGTOOLS.COM (Oct. 23, 2021), https://www.accountingtools.com/articles/accounting-for-deferred-taxes.html.

52. Contingencies refer to events with uncertain outcomes, such as potential or pending lawsuits. *Accounting for Contingencies*, ACCOUNTINGTOOLS.COM (Dec. 27, 2021), https://www.accountingtools.com/articles/accounting-for-contingencies.html#:~:text=A%20contingency%20arises%20when%20there,amount%20can%20be%20reasonably%20estimated.

53. Audit workpapers are the accountant's documentation of the evidence provided, the auditor's assessment, and ultimate conclusions that are drawn as a result. PUB. CO. ACCT. OVERSIGHT

Section D: Evolution of the Accountant-Client Privilege

Accountant-client privilege evolved through a series of Supreme Court cases. The Supreme Court in *Couch v. United States* affirmatively declared "no confidential accountant-client privilege exists under federal law and no state-created [sic] privilege has been recognized in federal cases."[54] In *Couch*, the IRS sought enforcement of a subpoena for copies of all the defendant's accounting records, accountant workpapers, and underlying documentation as part of an IRS criminal investigation.[55] The Court dismissed the defendant's claim the Fifth Amendment protects accounting documentation from production. [56] In doing so, the Court found the Fifth Amendment allows production of incriminating statements from sources other than the defendant.[57] However, the Court did not state whether discovery was allowed if the workpapers contained accountant or attorney work-product.

Despite the Court's declaration in *Couch*, states have created a statutory accountant-client privilege. Prior to 1968, sixteen States and the Commonwealth of Puerto Rico enacted accountant-client privilege statutes.[58] By 2001, twenty-nine U.S. jurisdictions had laws in place at least keeping accountant communications confidential, but not necessarily protecting them from disclosure.[59] One public policy notion underlying accountant-client privilege is that heightened disclosure between the auditor and the client benefits the public.[60] As recent accounting research confirms, increased transparency between auditor and client benefits the public by providing higher quality analysis to improve the investing public's decision-making processes.[61]

Section E: Third Party Access to Accountant Work-Papers

In *Arthur Young & Co.*, the Court disagreed with the public policy notions of accountant work-product protections and allowed discovery of sensitive ac-

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BD., STATEMENT ON AUDITING STANDARDS NO. 339A: WORKING PAPERS §§ .04-5 (2004), https://pcaobus.org/oversight/standards/archived-standards/details/AU339A.

54. Couch v. United States, 409 U.S. 322, 335 (1973).

55. *Id.* at 323.

56. *Id.* at 322.

57. *Id.* at 328.

58. Mich. L. Rev., *Privileged Communications—Accountants and Accounting—A Critical Analysis of Accountant-Client Privilege Statutes*, 66 MICH. L. REV. 1264, 1264 (1968).

59. Michael W. Loudenslager, *Cover Me: The Effects of Attorney-Accountant Multidisciplinary Practice on the Protections of the Attorney-Client Privilege*, 53 BAYLOR L. REV. 33, 68 (2001).

60. Mich. L. Rev., *supra* note 58, at 1271.

61. *Id; See also* Anderson et al., *supra* note 14, at 858 ("[C]lients . . . were less inclined to withhold information regarding specific contingent liabilities in an environment where auditors could more easily detect this behavior").

countant workpapers that included incriminating information about the client.[62] In so deciding, the Court addressed the question of whether accountant workpapers discussing the probability of success on a company's tax position could be protected from discovery as work-product.[63] The IRS sought enforcement of a subpoena for accountant tax workpapers as part of a criminal investigation.[64] These workpapers included an item-by-item analysis of the company's potential exposure to additional tax liability based on its tax return positions.[65] These documents are referred to as the "soft spots" of the company's tax return because they reveal where the company's tax positions are most vulnerable.[66] The Court's analysis focused on the competing priorities of securities regulation versus the federal tax system's need for information.[67] The Court believed that a Congressional grant of authority to obtain relevant information was apparent in the statute and therefore necessitated transparency in the tax system.[68] When assessing whether the documents were discoverable, the Court believed protecting accountant workpapers would create a testimonial privilege similar to the one dismissed in *Couch*.[69] Ultimately, the Court believed the voluntary nature of U.S. tax compliance and the prior holding in *Couch,* combined with the lack of an unambiguous Congressional direction, necessitated a ruling for the IRS.[70]

The Court went further and stated the accountant has a "*public* responsibility transcending any employment relationship with the client."[71] In response to the plaintiff's claim of a potential "chilling effect" on communication between auditors and clients, the Court reasoned that an auditor can issue a disclaimer of opinion if the corporate client was not forthcoming.[72] The Court believed management's fear of an adverse opinion from the accountant would lead management to cooperate with auditors.[73] However, subsequent accounting research indicates corporate clients continue to withhold information from auditors, in ad-

62. *See* United States v. Arthur Young & Co., 465 U.S. 805, 818 (1984) ("We cannot accept the view that the integrity of the securities markets will suffer absent some protection for accountants' tax accrual workpapers.").

63. *See id.* at 805–06.

64. *Id.* at 813.

65. *Id.*

66. *Id.*

67. *Id.* at 815.

68. *Id.* at 820 ("Congress has granted to the IRS 'broad latitude to adopt enforcement techniques helpful in the performance of [its] tax collection and assessment responsibilities.'" (citing United States v. Euge, 444 U.S. 707, 716 n.9 (1980))).

69. *See id.* at 817 ("In light of *Couch*, the Court of Appeals' effort to foster candid communication between accountant and client by creating a self-styled work-product privilege was misplaced, and conflicts with what we see as the clear intent of Congress.").

70. *Id.* at 816.

71. *Id.* at 817.

72. *Id*. at 818.

73. *Id.* at 818–19 ("Responsible corporate management would not risk a qualified evaluation of a corporate taxpayer's financial posture to afford cover for questionable positions reflected in a prior tax return").

dition to taking fewer arguable tax positions.[74] This subsequent research demonstrates how the broad language of the opinion reduced communication between client and auditor, which continues to impair the information provided to the securities markets.

PART II: THE PROBLEM

This broad language creates a wall preventing information sharing between lawyers and auditors. The contingencies account and deferred taxes account require the auditor to assess whether management's position on pending or potential litigation is reasonable and accurately reflected in the financial statements.[75] If it is probable the company will lose, the auditor must determine a reasonable valuation of the loss.[76] In practice, the auditor must work with internal and external counsel to determine the likelihood the company will prevail in pending litigation.[77] In doing so, the auditor uses the attorney's work-product and analysis.

The optional American Bar Association ("ABA") guidelines ask lawyers to work with auditors and provide a framework for assessing the types of disclosures that must be made.[78] As a result of this process, lawyers are trapped: they are risking securities litigation for their client if they fail to provide materials to the auditor[79] but providing an assessment to the auditor of the company's legal strategy may waive attorney work-product protections. Disclosure of privileged communications to an independent auditor waives attorney-client privilege because the communications are disclosed outside the privileged circle.[80] Howev-

74. Anderson et al., *supra* note 14, at 857.

75. *See* FIN. ACCT. STANDARDS BD., *Statement of Financial Accounting Standards No. 5: Accounting for Contingencies* (1975), https://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820910926&blobheader=application/pdf; PRICEWATERHOUSECOOPERS, *Chapter 23: Commitments, contingencies, and guarantees*, (Apr. 30, 2022), shorturl.at/bdAZ2.

76. *Id.*

77. *See* United States v. Arthur Young & Co., 465 U.S. 805, 812 (1984) ("The auditor will also obtain and assess the opinions, speculations, and projections of management with regard to unclear, aggressive, or questionable tax positions that may have been taken on prior tax returns.").

78. Michael F. Sharp & Abraham M. Stanger, *Audit-Inquiry Responses in the Arena of Discovery: Protected by the Work-Product Doctrine*, 56 BUS. L. 183, 184 (2000).

79. *See* Alan J. Wilson et. al, *The ABA Statement on Audit Responses: A Framework That Has Stood the Test of Time*, 75 BUS. L. 2085, 2095 (2020) (describing instances where companies were subject securities litigation for failure to accrue contingencies).

80. *See, e.g.,* First Horizon Nat'l Corp. v. Hous. Cas. Co., No. 2:15-cv-2235-SHL-dkv, 2016 WL 5867268, at *10 (W.D. Tenn. Oct. 5, 2016) (holding that both attorney-client privilege and work-product protections were waived in disclosing to the outside auditor); United States v. Hatfield, No. 06-CR-0550 (JS), 2010 WL 183522, at *1–2 (E.D.N.Y. Jan. 8, 2010) (holding that since the accountant was not retained to further the litigation, there was no attorney-client privilege accorded to the documents); Eglin Fed. Credit Union v. Cantor Fitzgerald Sec. Corp., 91 F.R.D. 414, 419 (N.D. Ga. 1981) (holding that the failure to take precautions when disclosing information to the outside auditor waived attorney-client privilege because it broke the confidentiality of the communications).

er, it is unclear whether disclosure in this context waives attorney work-product protections. This section will first describe the inconsistent judicial decisions on whether disclosure to the outside auditor waives attorney work-product protections. Then it will analyze why this waiver of work-product protections undermines the *Hickman* doctrine. Finally, this section will analyze how this type of waiver is detrimental to the information being provided to the securities markets.

Section A: Accountant-Related Work-Product Waiver Undermines the Attorney Work-Product Doctrine

Courts have taken divergent approaches on whether disclosing confidential documents to the outside auditor waives attorney work-product protections. At the circuit court level, courts are split on how to interpret the broad language of *Arthur Young & Co.*[81] The D.C. Circuit held that tax documents drafted by the outside auditor detailing the company's legal strategy did not waive attorney work-product protections,[82] interpreting *Arthur Young & Co* as explaining the discoverability of accountant work-product, not attorney work-product.[83] By contrast, the First Circuit held documents detailing the likelihood of success of the company's tax positions were not protected by attorney work-product.[84] The First Circuit believed the public interest was incompatible with protecting the analysis as either attorney work-product or accountant work-product, which implicitly adopts the "public responsibility" interpretation of *Arthur Young & Co*.[85] The dissent in the First Circuit's opinion, however, noted attorney work-product was not a question raised in *Arthur Young & Co.* and therefore the majority's reliance on the case is misplaced.[86] Each case turned on competing interpretations of *Arthur Young, & Co.*, and federal trial courts have followed these two lines of reasoning.

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81. *Compare* United States v. Textron Inc., 577 F.3d 21, 30–31 (1st Cir. 2009) (holding that tax pool workpapers opining on the company's chances of litigation success at not protected), *with* United States v. Deloitte LLP, 610 F.3d 129, 139 (D.C. Cir. 2010) (protecting from discovery a Deloitte memo that discussed the potential for tax litigation and included summaries of conversations with in-house counsel).

82. *Deloitte LLP*, 610 F.3d at 136.

83. *See id.* at 143 ("Likewise, the government's reliance on *Arthur Young* is misplaced. In *Arthur Young*, the Court considered whether *accountant* work-product should be granted the same protection *attorney* work-product receives.").

84. *Textron Inc.*, 577 F.3d at 30–31 (holding that tax pool workpapers opining on the company's chances of litigation success are not protected).

85. *See id.* (relying on *Arthur Young & Co.* to show the "essential public interest in revenue collection" requires the tax workpapers be disclosed, and referencing the advisory committee's note to Federal Rule of Civil Procedure 26 to show "public requirements unrelated to litigation" are not qualified for immunity under the work-product doctrine).

86. *Id.* at 42 (Torruella, J., dissenting).

Subsection 1: The Overly Broad "Public Duty" Line of Cases

At the federal trial court level, interpretations of the broad disclosure requirements follow either the "public responsibility" interpretation or the accountant work-product interpretation. Some courts believe disclosure to an independent auditor waives work-product protections.[87] Similar to the First Cir-Circuit, these cases follow the broad "public responsibility" interpretation that focuses on the notion that auditor and client do not have similar interests or responsibilities.[88] Applying this interests test leads these courts to hold that attorney work-product protections are waived.[89] For example, the work-product protections were deemed to be waived after release of the documents to auditors because the auditor's responsibilities to the public and the company's "litigation interest" were not sufficiently aligned to maintain the protections.[90] In the context of an audit, one court stated good auditing requires "[the auditors] must not share common interests with the company they audit" and therefore must be adversarial.[91] While many of these cases are decades old, this line of reasoning continues to appear in modern cases.[92] The "public responsibility" line of cases

87. *See, e.g.,* King Pharms., Inc. Sec. Litig., NO. 2:03-CV-77, 2005 WL 8142328, at *3 (E.D. Tenn. Sept. 21, 2005); Medinol, Ltd. v. Bos. Sci. Corp., 214 F.R.D. 113, 115–17 (S.D.N.Y. 2002) (holding disclosure of the meeting minutes of the "Special Litigation Committee" of the Board of Directors to the outside auditor constituted a waiver of work-product protection); Diasonics Sec. Litig., No. C-83-4584-RFP (FW), 1986 WL 53402, at *1 (N.D. Cal. June 15, 1986) (holding that disclosure of the documents to the outside auditor waived work-product protections because the auditor and the company do not share common interests in a way that would guarantee confidentiality).

88. *E.g., Diasonics Sec. Litig.*, 1986 WL 53402, at *1 ("[I]t appears that the protection was waived by disclosure to the accountants . . . the relationship between public accountant and client is at odds with such a guarantee [of confidentially] because the public accountant has responsibilities to creditors, stockholders, and the investing public which transcend the relationship with the client." (citing United States v. Arthur Young & Co., 104 S. Ct. 1495, 1503 (1984))); *Medinol*, 214 F.R.D. at 116–17 ("And, as has become crystal clear in the face of the many accounting scandals that have arisen as of late, in order for auditors to properly do their job, they *must* not share common interests . . . . Boston Scientific and its outside auditor Ernst & Young did not share "common interests" in litigation, and disclosures to Ernst & Young as independent auditors did not therefore serve the privacy interests that the work-product doctrine was intended to protect").

89. *See supra* note 87 and accompanying text.

90. *Medinol, Ltd.*, 214 F.R.D. at 115; *Diasonics Sec. Litig.*, 1986 WL 53402, at *1 ("[I]t appears that the protection was waived by disclosure to the accountants . . . the relationship between public accountant and client is at odds with such a guarantee [of confidentially] because the public accountant has responsibilities to creditors, stockholders, and the investing public which transcend the relationship with the client." (citing *Arthur Young & Co.*, 465 U.S. at 817)).

91. *See supra*, note 88 and accompanying text.

92. *See, e.g.,* Alton & S. Ry. Co. v. CSX Transp., Inc., No. 3:17-CV-01249-NJR, 2020 WL 4933652, at *4 (S.D. Ill. Aug. 24, 2020) (holding that disclosure to the outside auditor does not necessarily vitiate work-product protections because among other reasons, the company took steps to keep the documents away from the outside auditor); Durand v. Hanover Ins. Grp., Inc., 244 F. Supp. 3d 594, 619 (W.D. Ky. 2016) (holding that the fiduciary exception applies to the legal opinion letter given to the auditor, which implies the auditor's responsibilities are to the trustees as members of the public); First Horizon Nat'l Corp. v. Hous. Cas. Co., No. 2:15-cv-2235-SHL-dkv, 2016 WL 5867268, at *10 (W.D. Tenn. Oct. 5, 2016) (holding that both attorney-client privilege and work-

creates an adversarial dynamic in auditing and incentivizes companies to be as opaque as possible because disclosing damaging information may be adverse to a corporation's interests.[93] It seems perverse to tell companies their interests are adverse to the public and therefore they should withhold as much information as auditors will allow. Proponents of the "public responsibility" interpretation may argue auditors should perform their analysis independent of the lawyer to encourage the free exercise of their judgment. However, the accountant's analysis is best informed by unrestricted access to an attorney's thought processes to assess whether a contingency exists. An accountant performing independent analysis would be required to assess the probability of an adverse litigation outcome for the company, a task for which accountants are not well trained.

Subsection 2: The Doctrine Affirming Accountant Work-Product Line of Cases

Other courts rejected the "public responsibility" logic.[94] In its review of trial court opinions, the D.C. Circuit Court noted the majority of district courts have held disclosure of attorney work-product-protected documents to outside auditors does not waive the protection.[95] Courts adopted various justifications when determining that disclosure to the auditor does not waive work-product protections.[96] The Northern District of Illinois explained disclosure to the outside auditor should not waive attorney work-product protections because, among other reasons, allowing this waiver would fundamentally undermine the attorney work-product doctrine.[97] The Northern District of Illinois rightfully recognized that a duty to maintain independence does not necessarily mean the

product protections were waived in disclosing to the outside auditor by joining the reasoning in *King Pharmaceuticals*).

93. *See Arthur Young & Co.*, 465 U.S. at 818 ("This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.").

94. United States v. Deloitte LLP, 610 F.3d 129, 140 (D.C. Cir. 2010) (". . . [The auditor] is [not] a potential adversary for purposes of waiver analysis.").

95. *Id.* at 139 ("Among the district courts that have addressed this issue, most have found no waiver.") (internal citations omitted).

96. *See, e.g.,* Gutter v. E.I. Dupont de Nemours & Co., No. 95–CV–2152, 1998 WL 2017926, at *5 (S.D. Fla. May 18, 1998) ("Transmittal of documents to a company's outside auditors does not waive the work-product privilege because such a disclosure 'cannot be said to have posed a substantial danger at the time that the document would be disclosed to plaintiffs.'") (internal citations omitted); *Deloitte LLP*, 610 F.3d at 140 (" [The auditor] is [not] a potential adversary for purposes of waiver analysis.").

97. *See* Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 237 F.R.D. 176, 181 (N.D. Ill. 2006) ("The court also rejected the reasoning of *Gulf Oil* as contrary to the principles and purposes underlying the work product doctrine.") (internal citations omitted).

auditor's interests are adverse to the company's interests.[98] This logic, either explicitly or implicitly, adopts the interpretation of *Arthur Young, & Co.* as discussing accountant work-product protections, not attorney work-product protections.[99] Holding there is no waiver of attorney work-product protections requires this reading because protecting the documents cuts against the broad discoverability of accountant workpapers the Court described in *Arthur Young & Co.*[100]

The accountant work-product protection line of cases interprets *Arthur Young & Co.* in a way that is congruent with the Court's focus in *Hickman*. The Supreme Court relied on the instrumentality rationale when applying attorney-client privilege, which requires affirmative belief the privilege will be maintained.[101] Since the work-product doctrine is an extension of attorney-client privilege, one can surmise the instrumentality rationale is also in the attorney work-product doctrine. If courts read *Arthur Young & Co.* as continuing to protect attorney work-product, then lawyers will feel more comfortable when drafting their legal analysis. This reading would align with existing case law because interpreting *Arthur Young & Co.* as protecting attorney work-product adopts the instrumentality rationale and provides comfort to attorneys when drafting their legal analysis.

Subsection 3: The "Public Duty" Line of Cases Impairs the Attorney Work-Product Doctrine

Allowing third-party access to a lawyer's work-product through the auditor conflicts with the Court's holdings in *Hickman* and its extension into the criminal context in *United States v. Nobles*.[102] As illustrated by the current division of authority, the broad ruling from *Arthur Young & Co.* confused lower courts on whether to interpret the accountant's "public responsibility" obligation as a waiver of attorney work-product protections.[103] Scholars argue that broad waiv-

98. *Id.* at 183 ("In the court's view, the fact that an independent auditor must remain independent from the company it audits does not establish that the auditor also has an adversarial relationship with the client as contemplated by the work product doctrine.").

99. *See Deloitte LLP*, 610 F.3d at 143 ("Likewise, the government's reliance on *Arthur Young* is misplaced. In *Arthur Young*, the Court considered whether *accountant* work-product should be granted the same protection *attorney* work-product receives.").

100. *See* United States v. Arthur Young & Co., 465 U.S. 805, 818 (1984) ("To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.").

101. *See* EDWARD J. IMWINKELRIED, THE NEW WIGMORE: A TREATISE ON EVIDENCE: EVIDENTIARY PRIVILEGES § 5.1.1 (3d ed. 2021).

102. United States v. Nobles, 422 U.S. 225, 238 (1975); Hickman v. Taylor, 329 U.S. 495, 514 (1947).

103. First Horizon Nat'l Corp. v. Hous. Cas. Co., No. 2:15-cv-2235-SHL-dkv, 2016 WL 5867268, at *2 (W.D. Tenn. Oct. 5, 2016) ("In *King Pharmaceuticals*, the court noted that courts are split on whether an outside auditor is an adversary such that disclosure to the auditor would constitute a waiver of any privilege.") (internal citations omitted).

er rules erode the reliability of attorney work-product protections and negatively impact attorney behavior.[104] The work-product doctrine was originally created to allow lawyers to formulate their thoughts without undue intrusion from the opposing party.[105] However, formulating overly broad waiver rules allowing discovery of important documents, such as the minutes of a special litigation committee, erodes the comfort this rule provides.[106] Such a result undermines the integrity of the attorney work-product doctrine because it goes against the focal point of *Hickman* and *Nobles*, which was protection of the lawyer's mental thought processes.[107]

Allowing easy access to the attorney's opinion work-product through the auditor also contravenes the heightened protections it is typically afforded.[108] Work-product protections were intended to incentivize lawyers to document aspects of their legal strategy that would otherwise go undocumented.[109] Interpreting *Arthur Young & Co.* as creating a broad waiver provision undermines an important aspect of *Hickman* by enabling the easy access the Court intended to eliminate.[110]

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104. *See* Marcus, *supra* note 42, at 1606.

105. *Hickman*, 329 U.S. at 514 ("When [Federal Rules of Civil Procedure] Rule 26 and the other discovery rules were adopted, this Court and the members of the bar in general certainly did not believe or contemplate that all the files and mental processes of lawyers were thereby opened to the free scrutiny of their adversaries."); *see also Nobles*, 422 U.S. at 238 ("At its core, the work-product doctrine shelters the mental processes of the attorney . . .").

106. Medinol, Ltd. v. Bos. Sci. Corp., 214 F.R.D. 113, 115–17 (S.D.N.Y. 2002) (holding that disclosure of the meeting minutes of the "Special Litigation Committee" of the Board of Directors to the outside auditor constituted a waiver of work-product protection).

107. *See Hickman*, 329 U.S. at 514 ("When [the Federal Rules of Civil Procedure] Rule 26 and the other discovery rules were adopted, this Court and the members of the bar in general certainly did not believe or contemplate that all the files and mental processes of lawyers were thereby opened to the free scrutiny of their adversaries. And we refuse to interpret the rules at this time so as to reach so harsh and unwarranted a result."); *Nobles*, 422 U.S. at 238 ("At its core, the work-product doctrine shelters the mental processes of the attorney . . .").

108. *See* Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., 237 F.R.D. 176, 181 (N.D. Ill. 2006) (rejecting similar holdings that allowed for work-product waiver because they were "contrary to the principles and purposes underlying the work-product doctrine.") (internal citations omitted); *see also* discussion *supra* part I.A.

109. *See Hickman*, 329 U.S. at 511 ("Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten.").

110. *Id.*

Section B: Accountant Work-Product Waiver Undermines Information Provided to the Financial Markets

Viewing disclosure to a company's auditors as a waiver of work-product protections fundamentally undermines the audit because it reduces auditors' access to information. This conclusion is shown by the effects of the *Arthur Young & Co.* decision. After the decision, accounting research reached the tentative conclusion that companies shared less information with their auditors as a result of the case,[111] but, simultaneously, corporations took fewer arguable tax positions.[112] The same study showed, however, that the reduced client disclosure might not have changed financial statement accuracy.[113]

Subsequent research used tax information to show corporations often fail to disclose on their financials IRS claims for deficiencies in excess of five percent of income, which demonstrates financial statement inaccuracies were likely present in the account at issue in *Arthur Young & Co* even after the decision.[114] Further research suggests financial statement users place excessive reliance on explicit disclosures, revealing that the small amount of information which is disclosed may be unjustifiably relied on.[115] Tied together, the second two studies show that the earlier conclusion may have been premature. Reduced client disclosure does indeed alter financial statement accuracy, as auditors likely would require an adjustment to reported contingent tax liability if clients disclosed these claims.[116]

In the context of contingencies, failure to disclose important information could have a significant impact on the company's financial statement presentation. Research showed management disclosure of the higher of two possible outcomes, where both were equally likely, made investors pay more relative to the value of the underlying asset.[117] Additionally, the same paper noted that, where cognitive information processing limitations were strong, strategic agents could exploit them.[118] These conclusions allow us to draw the inference that failure to disclose strategic information in the context of valuing liabilities gives management the ability to manipulate their value. Accounting research also showed auditors are willing to tolerate greater potential misstatement when management makes more disclosures, supporting an inference of strategic management disclosure because management is incentivized to make the fewest dis-

111. Anderson et al., *supra* note 14, at 857.

112. *Id.*

113. *Id.*

114. Cristi A. Gleason & Lillian F. Mills, *Materiality and Contingent Tax Liability Reporting*, 77 ACCT. REV. 317, 317 (2002).

115. Jessen L. Hobson & Steven J. Kachelmeier, *Strategic Disclosure of Risky Prospects: A Laboratory Experiment*, 80 ACCT. REV. 824, 826 (2005).

116. *See* Gleason & Mills, *supra* note 114, at 317.

117. Hobson & Kachelmeier, *supra* note 115, at 825.

118. *Id.*

closures necessary to achieve their intended audit result.[119] Modern research further shows that management has been strategically disclosing nontrivial amounts of potential foreign taxes, which highlights the possibility for management to manipulate earnings.[120] The use of tax accounts to manipulate earnings was confirmed in another study that showed management used deferred taxes to manipulate or "manage" earnings.[121]

If given the opportunity, research suggests management will mislead investors and withhold information.[122] One study noted that when managers have an incentive to engage in practices that mislead investors about off-balance sheet financing, they will engage in these practices unless forced to disclose them.[123] Another study showed managers withhold bad news from the market when given the ability.[124] This study finally resolved the conflict in accounting research on whether managers have a tendency to disclose or withhold bad news.[125] In sum, the past thirty years of accounting research finally supports the inference that when management is able to withhold information under the guise of protecting their legal position and supplement with disclosures, liabilities could remain significantly understated.

This accounting research highlights the ongoing damage to the securities markets as a result of *Arthur Young & Co.* Management has the ability to hide behind non-disclosure of liabilities and attempt to achieve certain accounting results, which leads to misleading financial information being provided to investors. Companies currently listed on public exchanges could be misrepresenting material financial information. Auditors would be unable to identify these misrepresentations because management can hide behind the justification that disclosure will negatively impact their legal position. This problem must be addressed before another significant financial scandal hurts those who have invested their life savings in the markets.

More broadly, the Supreme Court's holding in *Arthur Young & Co.* that auditors have a duty to the public and thus their workpapers should be discovera-

119. Jeremy B. Griffin, *The Effects of Uncertainty and Disclosure on Auditors' Fair Value Materiality Decisions*, 52 J. ACCT. RES. 1165, 1165 (2014).

120. Benjamin C. Ayers et al., *Noncompliance with Mandatory Disclosure Requirements: The Magnitude and Determinants of Undisclosed Permanently Reinvested Earnings*, 90 ACCT. REV. 59, 59 (2013).

121. John Phillips et al., *Earnings Management: New Evidence Based on Deferred Tax Expense*, 78 ACCT. REV. 491, 491 (2003).

122. Bao et al., *supra* note 15, at 1.

123. *See* Sarah L. C. Zechman, *The Relation Between Voluntary Disclosure and Financial Reporting: Evidence from Synthetic Leases*, 48 J. ACCT. R. 725, 755 (2010) ("I also find that firms with incentives to use off-balance-sheet financing use synthetic leases but do not provide transparent disclosure about their leases.").

124. Bao et al., *supra* note 15, at 1.

125. *Id.*

ble fails to take into account how auditors can best serve the public.[126] As others have argued, the best way for auditors to serve the public is through meaningful access to information from clients.[127] Research shows clients interacting with auditors under a cloud of potential disclosure to an adversary such as the IRS are more likely to withhold important information.[128] This withholding gives management the ability to make misleading supplemental disclosures.[129] Therefore, protecting audit workpapers from discovery would be in the public interest because auditors would have better access to information to identify management malfeasance.

Furthermore, heightened access has not been shown to reduce auditor independence, thus maintaining a central tenant of audting. Audit independence can be divided into independence in appearance and independence of mind.[130] Independence in appearance, where the auditor appears independent of the client, would not be impaired. Heightened access to information would not impact a reasonable person's assessment of independence for the reason that heightened access to client information would not hinder an auditor's ability to assess that information.[131] Independence in mind would not be impaired because heightened access to information would not change the level of skepticism the auditor applies to management's assessment of their financial positions.[132] Allowing auditors access to more information will not change their mindset and arguably will make it harder for them to turn a blind eye to problems at the company because they are unable to argue they were barred access by the client.

PART III: THE SOLUTION

The previously discussed results of *Arthur Young & Co.* must be remedied to address the inconsistency with the attorney work-product doctrine and the impact on the U.S. securities markets. The best solution would be Congressional enactment of a statute narrowly extending attorney-client privilege protections to include discussions and documents exchanged between counsel and the company's accountants as part of a legally required audit. This solution would

126. United States v. Arthur Young & Co., 465 U.S. 805, 818 (1984) ("This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.").

127. *See* Frank J. Magill Jr., *The Accountant-Client Work Product Privilege*: United States v. Arthur Young & Co., 38 TAX L. 457, 465 (1985) ("The Court should have considered whether a work-product privilege is a necessary means to protect the financial reporting process and the public.").

128. Anderson et al., *supra* note 14, at 858.

129. Zechman, *supra* note 123.

130. *See* AM. INST. CERT. PUBLIC ACCTS., PLAIN ENGLISH GUIDE TO INDEPENDENCE 1 (2020), https://www.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/tools/downloadabledocuments/plain-english-guide.pdf.

131. *See id.*

132. *See id.*

disturb little precedent and remedy the issues previously discussed. Another author has advocated for a blanket federal accountant-client privilege to remedy this problem.[133] However, a blanket privilege for all communications between accountants and clients would unnecessarily undermine decades of precedent starting with *Couch*. A narrow privilege would accomplish the same objective without significantly disturbing existing Supreme Court precedent. This section will first discuss the need for Congressional action to create this privilege. Next, it will turn to how courts can partially address the solution through adopting the accountant work-product line of cases.

Section A: Future Congressional Action

Congress should act now and pass a statute in response to the recent financial scandals that rocked Wall Street. The past several years have seen a worrying trend of companies failing to disclose market-moving financial information such as a large publicly traded corporation's failure to disclose $15 billion in reserves[134] or allegations another publicly traded company used unlawful accounting methods.[135] This ongoing failure to disclose critical information hurts investor confidence in the securities markets and harms the life savings of average people. Creating a statutory privilege to partially address this failure allows auditors to engage in the public watchdog behavior the Supreme Court emphasized because it will allow them access to all of a company's financial information rather than only the material that does not damage the company's litigation position. Without this statutory enactment, society may continue to see financial scandals because auditors do not have access to the important information they need to ensure retail investors properly value the stocks they are buying.

A statute is necessary to overcome the common law's rule explicitly denying any accountant-client privilege.[136] The Court's holding in *Couch* and subsequent affirmation in *Arthur Young & Co* make clear there is no common law privilege for communications between accountants and their clients.[137] As the prior discussion highlighted, without this privilege, information sharing between auditors and lawyers opens the door to potential discovery of opinion attorney work-product by the opposing party.

To effectively shut this door, a privilege, not a work-product protection, must be enacted to protect those conversations. Such an enactment would fol-

133. R. Alexander Swider, *Toeing the Line: The Delicate Balance Between Attorneys Must Maintain when Responding to Auditor Inquiry Request Letters,* 50 IND. L. REV. 969, 989 (2017).

134. Michaels & Gryta, *supra* note 16.

135. Lorraine Mirabella, *Federal Regulators Escalate Investigation of Accounting Practices at Under Armour*, BALT. SUN (July 27, 2020, 6:32 PM), https://www.baltimoresun.com/business/bs-bz-under-armour-sec-accounting-probe-wells-20200727-6mev5vln6jbkxlif3uplmtuu5i-story.html.

136. *See* United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984); Couch v. United States, 409 U.S. 322, 335 (1973).

137. *Arthur Young & Co.*, 465 U.S. at 817; *Couch*, 409 U.S. at 335.

low the English evolution of legal privileges.[138] The English foundation on which American attorney work-product rests started with privileged conversations between attorney and client then extended to attorney work-product protections.[139] In the accounting context, a starting Congressional privilege would likely be extended to cover work-product as well. If only a work-product protection applied, then documents drafted to provide legal advice, but not in anticipation of litigation, would not be covered. In addition, the privilege will provide necessary guidance to courts and attorneys, who do not always apply work-product protections, privilege, or both to cases involving disclosure to an outside auditor.[140]

When drafting the statute, Congress would need only to make a statutory enactment because it would be absorbed by the Federal Rules of Evidence ("FRE"), Civil Procedure ("FRCP"), and Criminal Procedure. The FRE import privileges from the common law, except where a federal statute supersedes the common law.[141] As previously discussed, common law explicitly excludes an accountant-client privilege. Therefore, a congressional enactment is required to create this privilege. Explicitly listing the privilege in the Federal Rules of Evidence is unnecessary and would break with the prior Congressional approach to the FRE. In drafting FRE 501, the drafters vetoed proposals to explicitly list the privileges available under federal law, thus foreclosing the possibility of a direct amendment to the FRE.[142] However; the rules allow for statutory privilege enactments, which will then be absorbed by the other federal rules.[143] Similar to the tax preparer privilege afforded to accountants in another context,[144] Congress could create a narrow privilege for interactions between auditors and clients as part of a SEC required audit.

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138. *See* Richard S. Pike, *The English Law of Legal Professional Privilege: A Guide for American Attorneys*, 4 LOYOLA U. CHIC. INT'L L. REV. 51, 60 (2006) (detailing how the English litigation privilege, which is roughly analogous to American work-product privilege, became intertwined with the legal advice privilege during the English evolution of testimonial privileges).

139. *See id.*

140. *Compare* Masillionis v. Silver Wheaton Corp., No. CV 15-5146-CAS(PJWx), 2018 WL 1725649, at *4 (C.D. Ca. 2018) (holding that attorney-client privilege over documents was waived when they were disclosed to the outside auditor), Eglin Fed. Credit Union v. Cantor, Fitzgerald Sec. Corp., 91 F.R.D. 414, 419 (N.D. Ga. 1981) (holding that the failure to take precautions when disclosing information to the outside auditor waived attorney-client privilege because it broke the confidentiality of the communications), *and* United States v. Hatfield, 2010 WL 183522, at *1–2 (E.D.N.Y. 2010) (holding that since the accountant was not retained to further the litigation, there was no attorney-client privilege or work-product protections accorded to the communications), *with* Frank Betz Assocs. v. Jim Walter Homes, Inc., 226 F.R.D. 533, 535 (D.S.C. 2005) (holding that disclosure of work-product protected documents to the outside auditor did not waive the protection).

141. FED. R. EVID. 501.

142. *See* FED. R. EVID. 501 advisory committee's note to 1974 enactment.

143. FED. R. EVID. 501.

144. Salem Financial, Inc. v. United States, 102 Fed. Cl. 793, 797 (Fed. Cl. 2012) (noting the statutory privilege for accountants as tax preparers in the federal system).

Amendments to either the Federal Rules of Civil or Criminal Procedure would be duplicative and unnecessary. Federal Rule of Civil Procedure 26 governing discovery imports the privileges stated in the FRE, which forecloses an amendment to the rules of civil procedure because the rules of civil procedure draw upon the rules of evidence.[145] Additionally, the privilege afforded in the criminal context was an extension of the civil context because *Nobles* extended the civil law rule articulated in *Hickman*.[146] In doing so, it is likely that the criminal context will import the privilege notion from the FRE similar to the civil context. The current system imports the privileges from the FRE, so, in enacting a statute that affects both the rules of civil procedure and criminal procedure, it would remain unclear whether it would be imported to the rules of evidence. This shows the rules of evidence should be amended to avoid confusion.

A Congressional amendment granting a narrow accountant-client privilege in a required audit would also harmonize the Federal Rules of Evidence on privilege with the work-product doctrine.[147] As noted above, there is an inconsistency where broad waiver allows easy access in contravention of *Hickman*.[148] This privilege would ensure there was no waiver when disclosing the information to the auditor because they would be within the privileged circle.

Additionally, this amendment would enable the auditor's valuation[149] and recognition[150] assessments to be more accurate and thus increase the quality of information given to the markets. When performing an audit, the auditor will look at whether a liability must be recognized and, if recognition is required, what is its valuation.[151] If the transaction is already being recorded in the contingencies account, then litigation is sufficiently imminent to trigger work-product

145. *See* C. CHARLES ALAN WRIGHT & ARTHUR W. MILLER, 8 FEDERAL PRACTICE AND PROCEDURE § 2016 (Supp. 1981); *see also In re* Int'l Horizons, Inc., 689 F.2d 996, 1002 (11th Cir. 1982) ("The meaning of the term 'privileged' under [Federal Rules of Civil Procedure] Rule 26(b)(1) is determined by reference to the Federal Rules of Evidence.") (internal citations omitted).

146. *See* United States v. Nobles, 422 U.S. 225, 238 (1975).

147. Fed. R. Civ. P. 26(b)(3)(B) ("If the court orders discovery of those materials [protected by work-product], it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.").

148. See discussion, *supra* Part II.

149. Valuation refers to the amount of the liability if one exists. FIN. ACCT. STANDARDS BD., *Statement of Financial Accounting Concepts No. 5: Recognition and Measurement in Financial Statements for Business Enterprises* at 1 (2021) https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176179210488&acceptedDisclaimer=true ("Measurement involves choice of an attribute by which to quantify a recognized item and choice of a scale of measurement (often called 'unit of measure').").

150. Recognition refers to whether the liability exists and the chance of an adverse outcome. *Id.* ("Recognition is the process of formally incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like.").

151. Denise Sullivan, *GAAP Guidelines for Contingent Liabilities*, CHRON., https://smallbusiness.chron.com/gaap-guidelines-contingent-liabilities-67481.html (last visited Nov. 18, 2020).

protections.[152] In the context of the contingencies account, auditors ask for the lawyer's analysis to determine whether the liability should be recognized, because the attorney's assessment of the case's merits will guide the accountant's recognition and valuation analysis.[153] This federal rule change would afford greater resiliency to the *Hickman* work-product doctrine and its extension to criminal cases, by providing comfort to the attorney that disclosure to the outside auditor will not waive the protections.[154] Moreover, the certainty of a privilege would enable auditors broader information access to detect malfeasance, which promotes accurate financial statements.[155] Auditors would be able to detect fraudulent behavior because lawyers would no longer be able to withhold information under the guise of hurting the company's legal position, and instead, must disclose their analysis of pending litigation to the auditor.

The Supreme Court challenged Congress to pass an equivalent statute at the case's conclusion in 1984.[156] Critics may argue that Congress' failure to enact such a statute indicates they do not believe it is a problem. At the time of the *Arthur Young & Co.* decision, Congress may have been reluctant to make changes because it believed, as did the Supreme Court, that the threat of a disclaimer of opinion would solve the problem.[157] Following the Court's decision, conclusions from accounting research on management behavior were tentative.[158] However, the slow march of accounting research over the last few decades—culminating in the 2019 study showing management will withhold bad news when they can—provides the necessary support for the amendment.[159] Recent accounting scandals further highlight the importance of auditor oversight. Recent allegations of improper accounting practices[160] highlight the importance of auditor access to critical accounting documentation. Thus, the combined presence of the need for transparent information being shared with

152. *See* Hickman v. Taylor, 329 U.S. 495, 508 (1947); *see* FIN. ACCT. STANDARDS BD., *supra* note 86, at 6 (noting that for a contingency to be disclosed or accrued, the likelihood of the adverse outcome must be at least a "reasonable possibility" but that companies have discretion in whether to disclose a contingency deemed "remote").

153. Sharp & Stanger, *supra* note 78, at 184.

154. *See* United States v. Nobles, 422 U.S. 225, 239–40 (1975); *Hickman*, 329 U.S. at 508.

155. *See* Anderson et al., *supra* note 14, at 858 ("[C]lients . . . were less inclined to withhold information regarding specific contingent liabilities in an environment where auditors could more easily detect this behavior.").

156. *See* United States v. Arthur Young & Co., 465 U.S. 805, 816 (1984) ("We are unable to discern the sort of 'unambiguous directions from Congress' that would justify a judicially created work-product immunity for tax accrual workpapers . . . .").

157. *Arthur Young & Co.*, 465 U.S. at 818.

158. Anderson et al., *supra* note 14, at 858.

159. Bao et al., *supra* note 15, at 1.

160. Lorraine Mirabella, *Under Armour Faces New Allegations of Fraudulent Accounting in Amended Shareholder Lawsuit*, BALT. SUN (Oct. 26, 2020, 4:20 PM), https://www.baltimoresun.com/business/bs-bz-under-armour-shareholder-lawsuit-20201026-uirlxcsdsbcqjlacekrcyhy3me-story.html.

investors as well as new accounting research support the conclusion that Congress must act.

Section B: A Current Judicial Solution

The Supreme Court should clarify its earlier ruling in *Arthur Young & Co.* as relating to accountant work-product, not attorney work-product, to follow the D.C. Circuit's analysis.[161] Additionally, courts around the country should follow the interpretation of *Arthur Young & Co.* that focuses on its aspects as an accountant work-product case and disregard the "public responsibility" line of cases.[162] As the D.C. Circuit noted, the majority of district courts have held disclosure does not constitute a waiver of attorney work-product protections, so this position would not overturn the majority of district court cases.[163] However, clarifying the doctrine only partially addresses the issue because it lacks the certainty of a privilege.

Additionally, applying this limitation would not overturn the results of prior Supreme Court cases. The Supreme Court's analysis in *Arthur Young & Co.* can be read to focus on the aspects of accountant work-product, not attorney work-product.[164] This interpretation is supported by the Supreme Court's focus on the accountant as certifying the entity's financial status, which shows an emphasis on the financial aspects of the audit, not the legal aspects.[165] The Court consciously chose language focusing on the accountant's workpapers as documenting the financial status of the organization, demonstrating that discovery should be limited to those documents detailing this financial status.[166] Moreover, as discussed in the D.C. Circuit's analysis, the Court was addressing whether work-product protected the accountant's documents, which is not the same as impairing the protections of the lawyer's documents.[167] If the Court

161. *See* United States v. Deloitte LLP, 610 F.3d 129, 143 (D.C. Cir. 2010) ("Likewise, the government's reliance on *Arthur Young* is misplaced. In *Arthur Young*, the Court considered whether *accountant* work-product should be granted the same protection *attorney* work-product receives.").

162. See discussion, *supra* part II.A.I. (discussing what is the accountant work-product line of cases versus the "public responsibility" line of cases).

163. *See Deloitte LLP*, 610 F.3d at 139 ("Among the district courts that have addressed [the issue of waiver when documents are produced to an outside auditor], most have found no waiver.").

164. *See* United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984) ("By certifying the public reports that collectively depict a corporation's *financial status*, the independent auditor assumes a public responsibility transcending any employment relationship with the client.") (emphasis added).

165. *See id.* at 819 ("Thus, the independent auditor's obligation to serve the public interest assures that the integrity of the securities markets will be preserved, without the need for a work-product immunity for *accountants' tax accrual workpapers*.") (emphasis added).

166. *Id.* at 817.

167. *See Deloitte LLP*, 610 F.3d at 143 ("Likewise, the government's reliance on *Arthur Young* is misplaced. In *Arthur Young*, the Court considered whether *accountant* work-product should be granted the same protection *attorney* work-product receives.").

intended for *Arthur Young & Co.* to undermine *Hickman* it could have explicitly stated that a lawyer's thought processes are discoverable in this context. The Court made no such statement. Thus, holding that disclosure of attorney work-product protected documents to an outside auditor does not waive those protections would be congruent with *Arthur Young & Co.* Additionally, extending this protection would align with *Couch*, which explicitly barred the accountant-client privilege in the federal system because it would relate only to attorney work-product disclosed to the accountant, not accountant work-product in general.[168] While some protections might exist for discussions between auditors and lawyers, the purpose of the protections would be to preserve the *Hickman* doctrine, not to provide an accountant-client privilege.

The problems with a sole judicial approach are twofold. Firstly, the auditor's analysis, which includes attorney input, could be discovered. As discussed above, the recognition and valuation sections of an accountant's workpapers are guided by the lawyer's assessment. Even if the lawyer's work-product is protected, the accountant's work-product would continue to convey meaningful information. Allowing discovery of this work-product could allow opponents access to this information through these workpapers.

Secondly, the current approach's uncertainty may induce the auditor to accidentally disclose the materials to opposing parties without the client's knowledge. A recent case highlighted the potential for accidental disclosure by the auditor to government agencies when external auditors are subpoenaed by the government to disclose certain information.[169] The court determined the information should ultimately be disclosed to all parties because of its exculpatory value.[170] The court recognized, however, that the auditors in that case may have made an error in disclosing potentially protected work-product to the government. [171] Without a privilege, these mistakes will recur because the doctrine remains unclear whether disclosure waives attorney work-product protections. This narrow privilege—applicable only in the context of SEC required audits—is necessary to prevent this issue from arising again.

CONCLUSION

Auditors play an important but underappreciated role in the securities industry. This position is hampered by tensions between auditors and in-house counsel. When discussing accounts that have legal implications with auditors, in-house counsel is motivated to withhold information. Disclosures between the company's lawyers and their auditors should be protected. Yet, the broad ruling in *Arthur Young & Co.* generated confusion in the application of the attorney

168. *See* Couch v. United States, 409 U.S. 322, 335 (1973).

169. *See* United States v. Petit, 438 F. Supp. 3d 212 (S.D.N.Y. 2020).

170. *Id.* at 215.

171. *Id.* (explaining the government was not prohibited from making the information available to the defendants "even if due to [the auditors]'s arguable error in producing the documents").

work-product doctrine to legal documents produced to auditors.[172] The current research and climate create a perfect situation for Congress to act now. Creating a privilege limited to discussions and disclosures to the auditor as part of a mandated securities audit would facilitate better information sharing and increase the information quality in the securities market. However, in the absence of Congressional action, the Supreme Court and lower courts should harmonize the law across U.S. jurisdictions by adopting the accountant work-product reading of *Arthur Young & Co.*. Doing so would align the existing case law with the focus of the work-product doctrine by protecting the lawyer's mental processes.[173] Solving this problem will lead to more transparent information sharing between client and auditor, which will in turn lead to better financial information in the markets as well as a stronger attorney work-product doctrine.

172. *Compare* Medinol, Ltd. v. Bos. Sci. Corp., 214 F.R.D. 113, 115–17 (S.D.N.Y. 2002) (holding that disclosure of the meeting minutes of the Special Litigation Committee of the Board of Directors to the outside auditor constituted a waiver of work-product protection), *with In re* Pfizer Inc. Sec. Litig., No. 90 Civ. 1260 (SS), 1993 WL 561125, at *8 (S.D.N.Y. Dec. 23, 1993) (mentioning that disclosure of work-product to an insurer is not a waiver in the same way that disclosure of work-product to an outside auditor is not a waiver), *and* Merrill Lynch & Co. v. Allegheny Energy, Inc., 229 F.R.D. 441, 447 (S.D.N.Y. 2004) (holding that disclosure of internal investigation reports to the outside auditors did not waive work-product protection).

173. *See* United States v. Nobles, 422 U.S. 225, 238 (1975) ("At its core, the work-product doctrine shelters the mental processes of the attorney . . . .").