

**SUPREME COURT OF NORTH CAROLINA**

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COMMSCOPE CREDIT UNION,	)	
	)	
Plaintiff-Appellee,	)	
	)	
v.	)	<u>Catawba County</u>
	)	12 CVS 3021
BUTLER & BURKE, LLP, a North	)	COA14-273
Carolina Limited Liability Partnership,	)	
	)	
Defendant and Third-Party Appellant,	)	
	)	
v.	)	
	)	
BARRY D. GRAHAM <i>et al.</i> ,	)	
	)	
Third-Party Defendant-Appellees.	)	

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**BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES  
OF AMERICA AS *AMICUS CURIAE* SUPPORTING APPELLANT**

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## INTEREST OF *AMICUS CURIAE*

The Chamber of Commerce of the United States of America is the world's largest business federation. Boasting over 300,000 members, the Chamber represents the interests of more than three million companies and professional organizations of every size, in every sector, and from every region of the country. To that end, the Chamber regularly files *amicus curiae* briefs in cases of concern to the Nation's business community.

The Chamber submits this brief because the Court of Appeals' holding that an independent-audit engagement can alone establish a fiduciary relationship between the auditor and its client places North Carolina law at odds with generally accepted auditing standards and a multitude of federal and state laws and regulations. By definition, independence is incompatible with fiduciary status.

If left to stand, the Court of Appeals' decision would disrupt audit practice in North Carolina and elsewhere, creating confusion among public accountants about their responsibilities to their audit clients and to the public. The American Institute of Certified Public Accountants (AICPA)—the organization that promulgates and refines generally accepted auditing standards in the United States—has emphasized that an auditor must avoid even the *appearance* of a lack of independence. *See* AICPA AU § 220.03. With the decision below on the books, it's unclear how a public accountant serving a North Carolina client could possibly comply with that standard: Under North Carolina law, a fiduciary must always act in the other party's best interest. The decision thus leaves

auditors in a quandary, requiring them to discharge irreconcilable duties—one to maintain independence from and another to maintain loyalty to their audit client.

There's more. With auditors' impartiality in the balance, public confidence in audit reports generated in North Carolina (or for North Carolina companies) would wane. Investors and creditors rely on corporate financial statements to make investment or lending decisions; they use independent audit reports to gauge the reasonableness of those financial statements. With auditors torn between competing duties of independence and loyalty, public confidence in the impartiality of audit reports would diminish. And when investor confidence suffers, the economy suffers.

### **ARGUMENT**

Auditor independence “is fundamentally inconsistent with status as a fiduciary.” Thomas L. Goldwasser and M. Thomas Arnold, “Breach of Fiduciary Duty,” *Accountant's Liability* § 7:1.3 (1996). The very concept of *public* accounting rests on that assumption.

The Court of Appeals' holding that an independent-audit engagement alone can give rise to a fiduciary duty flies in the face of generally accepted auditing standards and a mountain of federal and state laws, rules, regulations, and judicial decisions—including North Carolina's *own* statutes and regulations.

This Court should spare North Carolina auditors (and auditors for North Carolina clients) from perpetual questioning about their independence. It should dismiss the fiduciary claim against Butler & Burke LLP. To hold otherwise would deal a blow to investor confidence in a still-fragile economic environment.

**I. BY DEFINITION, AN INDEPENDENT AUDIT CANNOT GIVE RISE TO A FIDUCIARY DUTY.**

“The auditor must maintain independence in mental attitude in all matters relating to the audit.” AICPA AU § 220.01.<sup>1</sup> So reads the second generally accepted auditing standard, memorializing one of the core tenets of public accounting.<sup>2</sup> Indeed, the concept of independence is so fundamental to public accounting that we reflexively call auditors “independent auditors.” Independence, just as much as competency, is “the foundation of the public accounting profession.” AICPA, *Audits by Certified Public Accountants: Their Nature and Significance* (1950), at 25.

That is so for obvious reasons. Our Nation’s financial markets depend on financial statements to gauge companies’ financial health and creditworthiness; independent audit reports allow investors and lenders to test the reasonableness of those financial statements. “Public confidence [in those audit reports] would be impaired by evidence that independence was actually lacking.” AICPA AU § 220.03. For proof, see the Enron scandal.

To ensure auditor independence, generally accepted auditing standards require an auditor to be “free from any obligation to or interest in the [audit] client.” AICPA AU § 220.03. The auditor must demonstrate a “judicial

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<sup>1</sup> Like every other State, North Carolina requires public accountants to follow generally accepted auditing standards and to maintain independence throughout an audit engagement. 21 NCAC 08N.0403.

<sup>2</sup> The standard requiring auditor independence is preceded in listing (but not importance) by the requirement that an auditor “have adequate technical training and proficiency to perform the audit.” AICPA AU § 210.01.

impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors." AICPA AU § 220.02.

Apart from those standards, an uncountable number of federal and state laws and regulations require an auditor to maintain independence throughout an audit engagement. SEC rules, for instance, make it "unlawful for an auditor not to be independent" from an SEC-registered client. 17 C.F.R. § 240.10A-2; *see also* 15 U.S.C.S. § 7233 (making it unlawful for a registered public accounting firm to prepare an audit report for a securities issuer if the accounting firm has certain non-audit relationships with the issuer). Farm credit institutions—those community banks and credit unions that extend federal loans to farmers—"must ensure the independence of all qualified public accountants conducting the institution's audit." 12 C.F.R. § 621.30. And most States require companies subject to state audit requirements to ensure auditor independence. *See, e.g.,* McKinney's Laws of N.Y. Ann., 37 NPCL § 712-a (2015) (requiring companies subject to independent-audit requirements to "annually consider the performance and independence of the independent auditor"). The list of similar laws and regulations would stretch pages and pages.

Many of North Carolina's own laws and regulations would appear on that list. North Carolina's Insurance Commissioner must reject an insurer's audit report unless it comes from an "independent certified public accountant" who does not perform certain "nonaudit services" for the insurer. N.C. Gen. Stat.



Ann. § 58-10-210(g) (2014). And North Carolina’s accounting rules require a certified public accountant who “will issue a report on financial statements of any client (other than a report in which lack of independence is disclosed) [to] be independent with respect to the client in fact and appearance.” 21 NCAC 08N.0402(a). Those are just two examples. There are others. *See, e.g.*, N.C. Gen. Stat. Ann. § 116B-8 (2014) (“If the Treasurer contracts with any other person to conduct an audit under this Chapter, the audit shall not be performed on a contingent fee basis or any other similar method that may impair an auditor’s independence or the perception of the auditor’s independence by the public.”).

In light of generally accepted auditing standards and the cascade of federal and state laws requiring auditor independence, “many courts squarely addressing the question have held that an independent auditor generally is not in a fiduciary relationship with its client. Some courts have gone so far as to observe that the nature of the independent auditor precludes a finding of fiduciary duty.” *Resolution Trust Corp. v. KPMG Peat Marwick*, 844 F. Supp. 431, 436 (N.D. Ill. 1994) (collecting cases).

The very idea of an independent auditor being duty bound to its client is inimical to the audit function. Under North Carolina law, a fiduciary must “act in the best interests of the other party.” *Dallaire v. Bank of Am., N.A.*, 367 N.C. 363, 367, 760 S.E.2d 263, 267 (2014). An auditor can’t maintain its independence while acting in its client’s best interest. Those are mutually exclusive pursuits.

The Court of Appeals reached the opposite conclusion by misconceiving

the auditor's role. According to the Court of Appeals, "even if the relationship between an accounting firm and its clients is not a fiduciary one as a matter of law," Butler & Burke's "pledge[] to 'plan and perform audit[s] to obtain reasonable assurance about whether the financial statements are free of material misstatements'" created a "special" relationship with its audit client, triggering a fiduciary duty. 764 S.E.2d 642, 648 (N.C. App. 2014). But there was nothing special about Butler & Burke's pledge. In *every* independent-audit engagement, the auditor must "plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." AICPA AU § 110.02. It's what industry standards require. The Court of Appeals failed to grasp that fact.

The Court of Appeals' misconception of the audit function also surfaced in its conclusion that an auditor's relationship with its client is "much more like that between 'attorney and client, broker and principal.'" 764 S.E.2d at 647 (internal quotation marks omitted). As the Supreme Court of the United States explained thirty years ago, that is wrong:

[T]he private attorney's role [is] as the client's confidential advisor and advocate, a loyal representative whose duty is to present the client's case in the most favorable possible light. An independent certified public accountant performs a different role. 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. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. 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.

*United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (emphasis in original).

This Court should correct the Court of Appeals' wayward approach.

## **II. IMPOSING FIDUCIARY STATUS ON AUDITORS WOULD UNDERMINE, NOT INSPIRE, PUBLIC CONFIDENCE IN AUDIT REPORTS.**

The Court of Appeals' decision would be bad enough if it simply opened up the courts to fiduciary litigation against independent auditors. Unfortunately, its effects would not stop there.

“Corporate financial statements are one of the primary sources of information available to guide the decisions of the investing public.” *Arthur Young*, 465 U.S. at 810. Because an independent auditor evaluates the reasonableness of financial documents that move the markets, it bears a public responsibility that extends beyond its contractual relationship with its client. The independent auditor “owes ultimate allegiance” to the company’s creditors and stockholders. *Id.* at 818.

Before making investment or lending decisions, untold numbers of the Chamber’s membership look to independent audit reports for a reasonably accurate picture of companies’ financial health. For those and other market participants, an auditor’s opinion that a company’s financial statements are free of material misstatement serves an important gating function in the investment process. Auditing standards requiring independence make it possible for investors and

creditors to evaluate an audit opinion without worrying that the auditor had some motive to paint a rosier picture than the facts warranted.

The Court of Appeals' opinion threatens to change all that for North Carolina audits. If public accountants in the State (or for companies in the State) must "act in the best interests of" their audit clients (*Dallaire*, 367 N.C. at 367), then the investing public would have reason to question whether their audit opinions reflect impartiality or fiduciary duty. When investors and creditors start asking those kinds of questions, markets stagnate. Economies falter.

This Court should retire the Court of Appeals' decision before it begins to work itself out in the marketplace.

### **CONCLUSION**

Independence is the *sine qua non* of an independent audit. The Court of Appeals' decision upended that foundational principle. This Court should dismiss the claim for breach of fiduciary duty.

April 6, 2015

Respectfully submitted,

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## **CERTIFICATE OF COMPLIANCE**

This brief complies with North Carolina Rule of Appellate Procedure 28(j)(2)(B) because it contains 1,906 words, excluding the parts of the brief exempted by the Rule.

This brief complies with North Carolina Rule of Appellate Procedure 28(j)(1)(B)'s typeface and type-style requirements because it was prepared using Microsoft Office Word 2010 in Times New Roman 14 point font, a proportionally spaced typeface.

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## APPENDIX

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## 12 CFR 621.30

This document is current through the March 26, 2015 issue of the Federal Register

*Code of Federal Regulations* > *TITLE 12-- BANKS AND BANKING* > *CHAPTER VI-- FARM CREDIT ADMINISTRATION* > *SUBCHAPTER B-- FARM CREDIT SYSTEM* > *PART 621-- ACCOUNTING AND REPORTING REQUIREMENTS* > *SUBPART E-- AUDITOR INDEPENDENCE*

### **§ 621.30 General.**

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Each Farm Credit institution must ensure the independence of all qualified public accountants conducting the institution's audit by establishing and maintaining policies and procedures governing the engagement of external auditors. The policies and procedures must incorporate the provisions of this subpart and § 612.2260 of this chapter.

### **Statutory Authority**

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#### **AUTHORITY NOTE APPLICABLE TO ENTIRE PART:**

Secs. 4.12(b)(5), 5.17, 5.22A, 8.11 of the Farm Credit Act([12 U.S.C. 2183](#),2252, 2257a, 2279aa-11); sec. 514 of Pub. L. 102-552.

### **History**

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[[71 FR 76111, 76120](#), Dec. 20, 2006; [72 FR 7927](#), Feb. 22, 2007]

#### **Annotations**

### **Notes**

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#### **[EFFECTIVE DATE NOTE:**

[71 FR 76111, 76120](#), Dec. 20, 2006, added Subpart E, and [72 FR 7927](#), Feb. 22, 2007, provides that [71 FR 76111](#) is effective Feb. 16, 2007.]

### **Research References & Practice Aids**

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#### **NOTES APPLICABLE TO ENTIRE TITLE:**

CROSS REFERENCES: Farmers Home Administration: See Agriculture, 7 CFR, chapter XVIII.

Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development: See Housing and Urban Development, 24 CFR, chapter II.

Fiscal Service: See Money and Finance: Treasury, 31 CFR, chapter II.

Monetary Offices: See Money and Finance: Treasury, 31 CFR, chapter I.

Commodity Credit Corporation: See Agriculture, 7 CFR, chapter XIV.

Small Business Administration: See Business Credit and Assistance, 13 CFR, chapter I.



Rural Electrification Administration: See Agriculture, 7 CFR, chapter XVII.

**NOTES APPLICABLE TO ENTIRE CHAPTER:**

[PUBLISHER'S NOTE: For Federal Register citations concerning Chapter VI Statements, see: [60 FR 57913](#), Nov. 24, 1995; [76 FR 54638](#), Sept. 1, 2011; [77 FR 65098](#), Oct. 25, 2012; [78 FR 63380](#), Oct. 24, 2013; [79 FR 63033](#), Oct. 22, 2014.]

[PUBLISHER'S NOTE: For Federal Register citations concerning Chapter VI statements on regulatory burden, see: [65 FR 21128](#), Apr. 20, 2000.]

LEXISNEXIS' CODE OF FEDERAL REGULATIONS

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## 15 USCS § 7233

Current through PL 114-6, approved 3/20/15

United States Code Service - Titles 1 through 54 > TITLE 15. COMMERCE AND TRADE > CHAPTER 98. PUBLIC COMPANY ACCOUNTING REFORM AND CORPORATE RESPONSIBILITY > AUDITOR INDEPENDENCE

### § 7233. Commission authority

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- (a) Commission regulations. Not later than 180 days after the date of enactment of this Act [enacted July 30, 2002], the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934 [[15 USCS § 78j-1](#)], as added by this title.
- (b) Auditor independence. It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934 [[15 USCS § 78j-1](#)], as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

### History

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(July 30, 2002, *P.L. 107-204*, Title II, § 208, [116 Stat. 775](#).)

### Annotations

### Notes

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#### References in text:

"This title", referred to in this section, is Title II of Act July 30, 2002, *P.L. 107-204*. For full classification of such Title, consult USCS Tables volumes.

### Research References & Practice Aids

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[69 Am Jur 2d. Securities Regulation--Federal § 452.](#)

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UNITED STATES CODE SERVICE

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**§ 240.10A-2**

(3) Submission of the report (or documentation) by the independent accountant as described in paragraphs (b)(1) and (b)(2) of this section shall not replace, or otherwise satisfy the need for, the newly engaged and former accountants' letters under Items 304(a)(2)(D) and 304(a)(3) of Regulation S-K, §§ 229.304(a)(2)(D) and 229.304(a)(3) of this chapter, respectively, and shall not limit, reduce, or affect in any way the independent accountant's obligations to comply fully with all other legal and professional responsibilities, including, without limitation, those under generally accepted auditing standards and the rules or interpretations of the Commission that modify or supplement those auditing standards.

(c) A notice or report submitted to the Office of the Chief Accountant in accordance with paragraphs (a) and (b) of this section shall be deemed to be an investigative record and shall be non-public and exempt from disclosure pursuant to the Freedom of Information Act to the same extent and for the same periods of time that the Commission's investigative records are non-public and exempt from disclosure under, among other applicable provisions, 5 U.S.C. 552(b)(7) and § 200.80(b)(7) of this chapter. Nothing in this paragraph, however, shall relieve, limit, delay, or affect in any way, the obligation of any issuer or any independent accountant to make all public disclosures required by law, by any Commission disclosure item, rule, report, or form, or by any applicable accounting, auditing, or professional standard.

INSTRUCTION TO PARAGRAPH (C): Issuers and independent accountants may apply for additional bases for confidential treatment for a notice, report, or part thereof, in accordance with § 200.83 of this chapter. That section indicates, in part, that any person who, pursuant to any requirement of law, submits any information or causes or permits any information to be submitted to the Commission, may request that the Commission afford it confidential treatment by reason of personal privacy or business confidentiality, or for any other reason permitted by Federal law.

[62 FR 12749, Mar. 18, 1997, as amended at 73 FR 973, Jan. 4, 2008]

**§ 240.10A-2 Auditor independence.**

It shall be unlawful for an auditor not to be independent under § 210.2-

**17 CFR Ch. II (4-1-14 Edition)**

01(c)(2)(iii)(B), (c)(4), (c)(6), (c)(7), and § 210.2-07.

[68 FR 6048, Feb. 5, 2003]

**§ 240.10A-3 Listing standards relating to audit committees.**

(a) Pursuant to section 10A(m) of the Act (15 U.S.C. 78j-1(m)) and section 3 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7202):

(1) *National securities exchanges.* The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f) must, in accordance with the provisions of this section, prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) *National securities associations.* The rules of each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o-3) must, in accordance with the provisions of this section, prohibit the initial or continued listing in an automated inter-dealer quotation system of any security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(3) *Opportunity to cure defects.* The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have an opportunity to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules also may provide that if a member of an audit committee ceases to be independent in accordance with the requirements of this section for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain an audit committee member of the listed issuer until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

(4) *Notification of noncompliance.* The rules required by paragraphs (a)(1) and (a)(2) of this section must include a requirement that a listed issuer must notify the applicable national securities

**21 NCAC 08N .0402 INDEPENDENCE**

(a) A CPA, or the CPA's firm, who is performing an engagement in which the CPA, or the CPA's firm, will issue a report on financial statements of any client (other than a report in which lack of independence is disclosed) must be independent with respect to the client in fact and appearance.

(b) Independence is impaired if, during the period of the professional engagement, a covered person:

- (1) Had or was committed to acquire any direct or material indirect financial interest in the client.
- (2) Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client; and
  - (A) The covered person (individually or with others) had the authority to make investment decisions for the trust or estate;
  - (B) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
  - (C) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
- (3) Had a joint closely held investment that was material to the covered person.
- (4) Except as permitted in the AICPA Professional Standards Code of Professional Conduct and Bylaws, had any loan to or from the client or any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

(c) Independence is impaired if during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm, his or her immediate family and close relatives, (as defined in the AICPA Code of Professional Conduct and Bylaws) or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.

(d) Independence is impaired if, during the period covered by the financial statements, or during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm was simultaneously associated with the client as a:

- (1) Director, officer, employee, or in any capacity equivalent to that of a member of management;
- (2) Promoter, underwriter, or voting trustee; or
- (3) Trustee for any pension or profit-sharing trust of the client.

(e) For the purposes of this Rule "Covered" person is

- (1) An individual on the attest engagement team;
- (2) An individual in a position to influence the attest engagement;
- (3) A partner or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date:
  - (A) the firm signs the report on the financial statements for the fiscal year during which those services were provided; or
  - (B) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis;
- (4) A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
- (5) The firm, including the firm's employee benefit plans; or
- (6) An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles (GAAP) for consolidation purposes) by any of the individuals or entities described in Subparagraphs (1) through (5) of this Paragraph or by two or more such individuals or entities if they act together;

(f) The impairments of independence listed in this Rule are not intended to be all-inclusive.

*History Note: Authority G.S. 55B-12; 57C-2-01; 93-12(9);  
Eff. April 1, 1994;  
Amended Eff. February 1, 2011; April 1, 2003.*

**21 NCAC 08N .0403      AUDITING STANDARDS**

- (a) Standards for Auditing Services. A CPA shall not render auditing services unless the CPA has complied with the applicable generally accepted auditing standards.
- (b) Statements on Auditing Standards. The Statements on Auditing Standards issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B-21.6, and shall be considered generally accepted auditing standards for the purposes of Paragraph (a) of this Rule.
- (c) Departures. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.
- (d) Copies of Statements. Copies of the Statements on Auditing Standards may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty-nine dollars (\$169.00) in paperback form or four hundred eighty-six dollars (\$486.00) in looseleaf subscription form as of the effective date of the last amendment to this Rule.

*History Note:*      *Authority G.S. 55B-12; 57C-2-01; 93-12(9);  
Eff. April 1, 1994;  
Amended Eff. July 1, 2010; February 1, 2006.*

## AU Section 110

# ***Responsibilities and Functions of the Independent Auditor***

Source: SAS No. 1, section 110; SAS No. 78; SAS No. 82.

Issue date, unless otherwise indicated: November, 1972.

.01 The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles. The auditor's report is the medium through which he expresses his opinion or, if circumstances require, disclaims an opinion. In either case, he states whether his audit has been made in accordance with generally accepted auditing standards. These standards require him to state whether, in his opinion, the financial statements are presented in conformity with generally accepted accounting principles and to identify those circumstances in which such principles have not been consistently observed in the preparation of the financial statements of the current period in relation to those of the preceding period.

## **Distinction Between Responsibilities of Auditor and Management**

.02 The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.<sup>1</sup> Because of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected.<sup>2</sup> The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 1997, by Statement on Auditing Standards No. 82.]

.03 The financial statements are management's responsibility. The auditor's responsibility is to express an opinion on the financial statements. Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate,

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<sup>1</sup> See section 312, *Audit Risk and Materiality in Conducting an Audit*, and section 316, *Consideration of Fraud in a Financial Statement Audit*. The auditor's consideration of illegal acts and responsibility for detecting misstatements resulting from illegal acts is defined in section 317, *Illegal Acts by Clients*. For those illegal acts that are defined in that section as having a direct and material effect on the determination of financial statement amounts, the auditor's responsibility to detect misstatements resulting from such illegal acts is the same as that for error or fraud. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 1997, by Statement on Auditing Standards No. 82.]

<sup>2</sup> See section 230, *Due Professional Care in the Performance of Work*, paragraphs .10 through .13. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 1997, by Statement on Auditing Standards No. 82.]



authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of these matters and internal control is limited to that acquired through the audit. Thus, the fair presentation of financial statements in conformity with generally accepted accounting principles<sup>3</sup> is an implicit and integral part of management's responsibility. The independent auditor may make suggestions about the form or content of the financial statements or draft them, in whole or in part, based on information from management during the performance of the audit. However, the auditor's responsibility for the financial statements he or she has audited is confined to the expression of his or her opinion on them. [Revised, April 1989, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards Nos. 53 through 62. As amended, effective for audits of financial statements for periods beginning on or after January 1, 1997, by Statement on Auditing Standards No. 78. Paragraph renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997. Revised, April 2002, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 94. Revised, March 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 106.]

## Professional Qualifications

**.04** The professional qualifications required of the independent auditor are those of a person with the education and experience to practice as such. They do not include those of a person trained for or qualified to engage in another profession or occupation. For example, the independent auditor, in observing the taking of a physical inventory, does not purport to act as an appraiser, a valuer, or an expert in materials. Similarly, although the independent auditor is informed in a general manner about matters of commercial law, he does not purport to act in the capacity of a lawyer and may appropriately rely upon the advice of attorneys in all matters of law. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997.]

**.05** In the observance of generally accepted auditing standards, the independent auditor must exercise his judgment in determining which auditing procedures are necessary in the circumstances to afford a reasonable basis for his opinion. His judgment is required to be the informed judgment of a qualified professional person. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997.]

## Detection of Fraud

**[.06–.09]** [Superseded January 1977 by Statement on Auditing Standards No. 16, as superseded by Statement on Auditing Standards No. 53, as superseded by section 316. Paragraphs renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997.]

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<sup>3</sup> The responsibilities and functions of the independent auditor are also applicable to financial statements presented in conformity with a comprehensive basis of accounting other than generally accepted accounting principles; references in this section to financial statements presented in conformity with generally accepted accounting principles also include those presentations. [Footnote added, effective for audits of financial statements for periods beginning on or after January 1, 1997, by Statement on Auditing Standards No. 78. Footnote renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997.]

## Responsibility to the Profession

.10 The independent auditor also has a responsibility to his profession, the responsibility to comply with the standards accepted by his fellow practitioners. In recognition of the importance of such compliance, the American Institute of Certified Public Accountants has adopted, as part of its Code of Professional Conduct, rules which support the standards and provide a basis for their enforcement. [Paragraph renumbered by the issuance of Statement on Auditing Standards No. 82, February 1997.]

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## AU Section 210

# *Training and Proficiency of the Independent Auditor*

**Source:** SAS No. 1, section 210; SAS No. 5.

**Issue date, unless otherwise indicated:** November, 1972.

**.01** The first general standard is:

The auditor must have adequate technical training and proficiency to perform the audit.

[Revised, November 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 113.]

**.02** This standard recognizes that however capable a person may be in other fields, including business and finance, he cannot meet the requirements of the auditing standards without proper education and experience in the field of auditing.

**.03** In the performance of the audit which leads to an opinion, the independent auditor holds himself out as one who is proficient in accounting and auditing. The attainment of that proficiency begins with the auditor's formal education and extends into his subsequent experience. The independent auditor must undergo training adequate to meet the requirements of a professional. This training must be adequate in technical scope and should include a commensurate measure of general education. The junior assistant, just entering upon an auditing career, must obtain his professional experience with the proper supervision and review of his work by a more experienced superior. The nature and extent of supervision and review must necessarily reflect wide variances in practice. The auditor charged with final responsibility for the engagement must exercise a seasoned judgment in the varying degrees of his supervision and review of the work done and judgment exercised by his subordinates, who in turn must meet the responsibility attaching to the varying gradations and functions of their work.

**.04** The independent auditor's formal education and professional experience complement one another; each auditor exercising authority upon an engagement should weigh these attributes in determining the extent of his supervision of subordinates and review of their work. It should be recognized that the training of a professional man includes a continual awareness of developments taking place in business and in his profession. He must study, understand, and apply new pronouncements on accounting principles and auditing procedures as they are developed by authoritative bodies within the accounting profession.

**.05** In the course of his day-to-day practice, the independent auditor encounters a wide range of judgment on the part of management, varying from true objective judgment to the occasional extreme of deliberate misstatement. He is retained to audit and report upon the financial statements of a business because, through his training and experience, he has become skilled in accounting and auditing and has acquired the ability to consider objectively

and to exercise independent judgment with respect to the information recorded in books of account or otherwise disclosed by his audit. [As amended July, 1975 by Statement on Auditing Standards No. 5.]

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## AU Section 220

### *Independence*

**Source: SAS No. 1, section 220.**

**Issue date, unless otherwise indicated: November, 1972.**

**.01** The second general standard is:

The auditor must maintain independence in mental attitude in all matters relating to the audit.

[Revised, November 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 113.]

**.02** This standard requires that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors.

**.03** It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. To be independent, the auditor must be intellectually honest; to be *recognized* as independent, he must be free from any obligation to or interest in the client, its management, or its owners. For example, an independent auditor auditing a company of which he was also a director might be intellectually honest, but it is unlikely that the public would accept him as independent since he would be in effect auditing decisions which he had a part in making. Likewise, an auditor with a substantial financial interest in a company might be unbiased in expressing his opinion on the financial statements of the company, but the public would be reluctant to believe that he was unbiased. Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.

**.04** The profession has established, through the AICPA's Code of Professional Conduct, precepts to guard against the *presumption* of loss of independence. "Presumption" is stressed because the possession of intrinsic independence is a matter of personal quality rather than of rules that formulate certain objective tests. Insofar as these precepts have been incorporated in the profession's code, they have the force of professional law for the independent auditor.

**.05** The Securities and Exchange Commission (SEC) has also adopted requirements for independence of auditors who report on financial statements filed with it that differ from the AICPA requirements in certain respects.<sup>[1]</sup>

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<sup>[1]</sup> [Footnote deleted, December 2001, to acknowledge the dissolution of the Independence Standard Board.]

**.06** The independent auditor should administer his practice within the spirit of these precepts and rules if he is to achieve a proper degree of independence in the conduct of his work.

**.07** To emphasize independence from management, many corporations follow the practice of having the independent auditor appointed by the board of directors or elected by the stockholders.

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AUDITS  
BY CERTIFIED  
PUBLIC  
ACCOUNTANTS

*... Their Nature  
and Significance*

AMERICAN INSTITUTE OF ACCOUNTANTS  
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years have developed, clarified, and vitalized standards which guide CPAs in the performance of their work.<sup>4</sup>

These standards are the underlying principles of auditing which govern the nature and extent of the evidence to be obtained by means of auditing procedures. They are broad in scope and concern both the CPA's personal qualifications and the quality of his work. Whereas auditing procedures must be varied to meet the requirements of the particular engagement, standards to be observed in selecting and applying the procedures are the same in all circumstances.

#### *Personal Standards*

Generally accepted auditing standards require the CPA to be proficient in accounting and auditing; he must have the training and experience necessary to perform any engagement he undertakes in a professional manner. The most widely recognized evidence that a person has attained this standard of competence is his possession of the right to call himself a Certified Public Accountant. As stated previously, this right is granted by each state to any person who can demonstrate that he possesses the requisite character, education, and training, and can pass a professional examination.

Practically all states use examinations prepared by the American Institute of Accountants to test the applicant's mastery of his subject. To pass these examinations the applicant must have completed a rigorous course of training involving instruction in the theory and practice of accounting, auditing and commercial law, and must have acquired experience in dealing with practical accounting problems. After becoming a CPA, the practicing auditor must continue to keep abreast of current developments in accounting and auditing techniques.

Independence, both historically and philosophically, is the foundation of the public accounting profession. The CPA must not only possess extensive technical skill; he must also maintain the highest standards of honest, objective judgment and consideration. Independence is one of his most important personal qualifications.

Independence is an attitude of mind much deeper than the surface display of visible standards. The standards may change or become more exacting, but the quality itself remains unchanged. Rules of conduct cannot of themselves, therefore, assure independence. They can, however, provide objective standards to guide the CPA in all his professional endeavors.

<sup>4</sup> See *Auditing Standards—Their Generally Accepted Significance and Scope*.—Special report by committee on auditing procedure (American Institute of Accountants, 1947).

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# **Accountants' Liability**

**Dan L. Goldwasser  
Thomas Arnold**

**7**

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***Breach of Fiduciary Duty***

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relationship."<sup>18</sup> Where, however, one party is accustomed to being guided by the judgment and advice of another or is otherwise justified in believing that another person will act in his or her interest, a fiduciary relationship exists.<sup>19</sup> Thus, important components of a fiduciary relationship appear to include discretion on the part of the fiduciary<sup>20</sup> and/or a dominance of one party over another.<sup>21</sup> Generally the question of whether a fiduciary relationship exists is a question of fact.<sup>22</sup>

Sometimes courts use the term "confidential relationship" in referring to such a relationship.<sup>23</sup>

**§ 7:1.3 Circumstances in Which Accountant Is Not a Fiduciary**

An accountant has no fiduciary duties to persons who have no contractual or other relationship with the accountant.<sup>23.1</sup> For example,

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18. *Thomson*, 604 S.W.2d 473, 476. *See also* *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP*, 40 P.3d 1206, 1218 (Wash. Ct. App. 2002) (testimony as to trust reposed in accountant held insufficient to create fiduciary relationship).
  19. *See Dominguez v. Brackey Enters.*, 756 S.W.2d 788, 791 (Tex. Ct. App. 1988), *writ of error denied*; RESTATEMENT OF RESTITUTION § 182 cmt. c (1937); and DOBBS, REMEDIES § 10.04 (West 1973); *but see* *Farragut Mortg. Co. v. Arthur Andersen, LLP*, No. 95-6231-B (Mass. Sup. Ct. Nov. 15, 1996) (accountant who advised client on a pooling of interest question not held to be a fiduciary).
  20. *See DeMott*, *supra* note 8, at 901 ("If the relationship, as the parties structure it, does not confer discretion on the 'fiduciary,' then his actions are not subject to the fiduciary constraint."); Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 541 (1949) ("The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty.").
  21. *Anderson & Steele*, *supra* note 5, at 244 ("The basis for fiduciary responsibility is dominance of one person over another."); *DeMott*, *supra* note 8, at 902 ("In many relationships in which one party is bound by a fiduciary obligation, the other party's vulnerability to the fiduciary's abuse of power or influence conventionally justifies the imposition of fiduciary obligation.").
  22. *Pope v. Univ. of Wash.*, 121 Wash. 2d 479, 852 P.2d 1055, 1063 (1993) (finding no genuine issue of fact), *cert. denied*, 114 S. Ct. 1061 (1994).
  23. *See* DOBBS, REMEDIES § 10.04 (West 1973) ("Sometimes courts use the term 'confidential relationship' as a synonym for fiduciary relationship."). Although they overlap, there is a technical difference between a confidential relationship and a fiduciary relationship. *See* Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 825 n.100 (1983).
  - 23.1. *TSG Water Res., Inc. v. D'Alba & Donovan Certified Pub. Accountants, P.C.*, 366 F. Supp. 2d 1212, 1227-28 (S.D. Ga. 2004) (finding that investor plaintiffs were third parties to audit contract and had no relationship, professional or otherwise, with the auditors, therefore, auditors owed no fiduciary duties to these plaintiffs); *Baldwin v. Kulch Assocs., Inc.*, 39 F. Supp. 2d 111 (D.N.H. 1998) (dismissing fiduciary duty claim against accountant who had allegedly solicited the purchase of stock).

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## ACCOUNTANTS' LIABILITY

there is no fiduciary relationship between an accountant who is engaged to audit the financial statements of a corporation and creditors of the corporation to whom the corporation provides copies of the financial statements and the report of the accountant,<sup>24</sup> or between an auditor and the purchasers of a client corporation's shares.<sup>25</sup> In addition, absent special circumstances, an accountant does not stand in a fiduciary relationship to shareholders of or partners in a client,<sup>25.1</sup> or to the beneficiaries of a decedent to whom an accountant provided

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24. *Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co.*, 715 S.W.2d 408, 416 (Tex. Ct. App. 1986) [affirming summary judgment in favor of accountants on cause of action for breach of fiduciary duty], *writ of error refused*. See also *Greenblatt v. Richard Potasky Jewelers*, 1994 WL 9754, at \*4 (S.D.N.Y. Jan. 13, 1994) [holding that independent auditor was not fiduciary of person who entered consignment contract with audit client]. *Allard v. Arthur Andersen*, 218(59) N.Y.L.J. 26 (N.Y. Sup. Ct. Sept. 23, 1997) [dismissing breach of fiduciary duty claim alleging improper performance of audit and no defect in consulting services]; *Fleet Nat'l Bank v. H&D Entm't, Inc.*, 926 F. Supp. 226 (D. Mass., 1996); *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 945 P.2d 317 (Ariz. Ct. App. 1996), *review denied*.
25. *Venturtech II v. Deloitte Haskins & Sells*, 790 F. Supp. 576, 588 (E.D.N.C. 1992) [granting summary judgment for accounting firm on claims brought by venture capital firms for breach of fiduciary duty], *aff'd sub nom. Heritage Capital Corp. v. Deloitte Haskins & Sells*, 993 F.2d 228 (4th Cir. 1993) *cert. denied*, 511 U.S. 1051, 114 S. Ct. 1609 (1994); *Shofstall v. Allied Van Lines*, 455 F. Supp. 351, 360 (N.D. Ill. 1978) [granting summary judgment for accountants on claim of breach of fiduciary duty; however, the accountants' motions for summary judgment on plaintiff's federal securities law and common law fraud claims denied]; *FDIC v. Schoenberger*, 781 F. Supp. 1155 (E.D. La. 1992); *Mishkin v. Peat Marwick Mitchell & Co.*, 744 F. Supp. 531 (S.D.N.Y. 1990); *Resolution Trust Co. v. KPMG Peat Marwick*, 844 F. Supp. 431 (N.D. Ill. 1994); *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1996); *Leder v. Shinfeld*, 609 F. Supp. 2d 386, 401-02 (E.D. Pa. 2009) [buyers of stock under stock purchase agreement were owed no fiduciary duty by accountant that provided professional services to companies whose shares they purchased].
- 25.1. See, e.g., *Golden W. Refining v. Pricewaterhouse*, 392 F. Supp. 2d 407, 413-14 (D. Conn. 2005) [granting summary judgment to defendant; under Connecticut law, accounting firm owed no fiduciary duties to parent corporation of its client]; *Richard B. LeVine, Inc. v. Higashi*, 131 Cal. App. 4th 566, 32 Cal. Rptr. 3d 244, 258-59 (2005) [accountants for partnership did not owe an "attributed" fiduciary duty to partner with whom they had no contact; providing a Schedule K-1 to individual partners satisfied a partnership obligation under Internal Revenue Code], *review denied*, 2005 Cal. LEXIS 13129 (Nov. 16, 2005); *Kopka v. Kamensky & Rubenstein*, 354 Ill. App. 3d 930, 821 N.E.2d 719, 727-28 (2004) [affirming dismissal of breach of fiduciary duty claims; accountants did not owe fiduciary duty to plaintiff as a shareholder and partner of corporate client].

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estate planning advice.<sup>25.2</sup> Similarly, an accountant generally has no fiduciary relationship with a director of a client, even where that director serves on the corporation's audit committee.<sup>25.3</sup>

An interesting case<sup>26</sup> on this point involved a person who was fired by his employer. He sued the employer's outside accountants alleging, among other things, that the accountants breached fiduciary duties owed to him by negligently or intentionally understating the employer's financial condition. The court dismissed the plaintiff's breach of fiduciary duty claim against the accounting firm.<sup>27</sup>

Even where an accountant has a relationship with a party, the accountant is not a fiduciary unless the party is justified in expecting the accountant to act in his or her interest. For example, in *Franklin Supply Co. v. Tolman*,<sup>28</sup> two corporations agreed to employ an accounting firm to audit a third corporation which was to be sold by one corporation to the other. The parties agreed to share the accounting fees equally. One of the corporations subsequently brought suit against the accounting firm alleging, among other things, that its lack of independence constituted a breach of fiduciary duty.<sup>29</sup> The trial court held that the accounting firm had a fiduciary relationship with the plaintiff. On appeal, the court stated that the duty of the accounting firm was not to act as a fiduciary for one of the parties, but rather to act independently as a fact finder. Thus, it could be held liable for negligence or fraud, but not for breach of fiduciary duty.<sup>30</sup>

An accountant is not a fiduciary where the accountant performs only tax preparation services.<sup>30.1</sup> In addition, an accountant is unlikely

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- 25.2. *Fitch v. McDermott, Will and Emery, LLP*, 929 N.E.2d 1167, 1187 (Ill. App. Ct. 2010) (finding that beneficiaries of trust had no standing to bring breach of fiduciary duty claims against accountant who assisted decedent in estate planning process), *appeal denied*, 938 N.E.2d 520 (Ill. Sept. 29, 2010) (Table, No. 110496).
- 25.3. *Cf. PricewaterhouseCoopers, LLP v. Massey*, 860 N.E.2d 1252, 1259 (Ind. Ct. App.) (finding that any injury suffered by the plaintiffs was derivative in nature), *transfer denied*, 869 N.E.2d 458 (Ind. 2007) (table).
26. *Hodge v. Dist. of Columbia Hous. Fin. Agency*, 1993 WL 121446 (D.D.C. Apr. 5, 1993).
27. *Id.* at \*2.
28. *Franklin Supply Co. v. Tolman*, 454 F.2d 1059 (9th Cir. 1972).
29. *Id.* at 1062.
30. *Id.* at 1065. However, the court affirmed the trial court's conclusion that the accounting firm was negligent. *Id.* at 1076-77.
- 30.1. *Iacurci v. Sax*, 57 A.3d 736, 750 (Conn. App. 2012), *cert. granted in part*, 61 A.3d 1100 (Conn. Feb 28, 2013) (No. 19119).

## § 7:1.4

## ACCOUNTANTS' LIABILITY

to be found to be a fiduciary where the plaintiff was not "accustomed" to being guided by the judgment and advice of the accountant.<sup>30.2</sup>

An accountant employed to audit the financial statements of a client is required to be independent of the client and, therefore, is not a fiduciary of the client.<sup>31</sup> The independence required of an auditor is fundamentally inconsistent with status as a fiduciary.<sup>32</sup> However, if an auditor "goes outside the normal role of independent auditor" and provides non-audit services to the audit client, a fact question may arise regarding whether the accounting firm has fiduciary duties to the client arising out of the non-audit services.<sup>32.1</sup>

**§ 7:1.4 Circumstances in Which Accountant Is a Fiduciary**

While the accountant-client relationship is generally not a fiduciary relationship,<sup>33</sup> a fiduciary relationship exists where a client justifiably reposes trust and confidence in an accountant to act in the client's interest. Such a relationship may exist where the accountant renders personal financial, investment, or tax advice to a client or where the accountant manages the assets or business of a client. In addition, an accountant for a pension fund who goes beyond the normal role of a

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- 30.2. *Staffenberg v. Fairfield Pagma Assoc., L.P.*, 944 N.Y.S.2d 568, 570 (App. Div. 2012) (affirming summary judgment; plaintiff sought investment advice, at most, once per decade; "These intermittent communications did not transform their conventional business relationship into a fiduciary relationship."); *In re Estate of Abernethy*, 390 S.W.3d 431, 438-39 (Tex. Ct. App. 2012) (affirming summary judgment for accountant; no competent summary judgment evidence that decedent accustomed to be guided by accountant's judgment and advice).
31. *Resolution Trust Co. v. KPMG Peat Marwick*, 844 F. Supp. 431, 436 (N.D. Ill. 1994) (granting motion to dismiss breach of fiduciary duty claim against auditor of bank); *FDIC v. Schoenberger*, 781 F. Supp. 1155, 1157-58 (E.D. La. 1992). See cases cited at *supra* note 24.
32. See *Painters of Phila. Dist. Council No. 21 Welfare Fund v. Price Waterhouse*, 879 F.2d 1146, 1150 (3d Cir. 1989). But see *In re DeLorean Motor Co.*, 56 B.R. 936, 945 (Bankr. E.D. Mich. 1986).
- 32.1. *In re Smartalk Teleservices, Inc. Sec. Litig.*, 487 F. Supp. 2d 928, 932 (S.D. Ohio 2007) (denying accountant's motion for summary judgment; genuine issue of material fact exists whether accountant's "role went outside the normal role of independent auditor so as to give rise to a fiduciary relationship").
33. *Stainton v. Tarantino*, 637 F. Supp. 1051, 1066 (E.D. Pa. 1986); *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 1314, 1356 (S.D.N.Y. 1982). But cf. *DeLorean Motor Co.*, 56 B.R. at 945 ("When performing audits, accountants are in the position of fiduciaries with their clients," court denied motion by corporation's accountants to dismiss third-party complaint alleging breach of fiduciary duty filed by director of corporation who was a member of audit committee board).

App. 000025

McKINNEY'S  
CONSOLIDATED LAWS  
OF  
NEW YORK  
ANNOTATED

Book 37

Not-For-Profit Corporation Law  
§§ 616 to 1200

Practice Commentaries  
by  
Rose Mary Bailly,  
William Josephson  
and Peter J. Kiernan

*With Annotations*  
From State and Federal Courts  
and State Agencies



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**DIRECTORS AND OFFICERS**

**§ 712-a**

**Art. 7**

McKinney's Forms, Not-For-Profit Corp. Law § 7:58, Special Committees—Clause in Bylaws (Form: N.Y. Not-For-Profit Corp. Law § 712).

McKinney's Forms, Not-For-Profit Corp. Law § 7:59, Committees of the Corporation—By-Law (Form: N.Y. Not-For-Profit Corp. Law § 712).

**Notes of Decisions**

Construction and application 1  
 Delegation of authority 2  
 Quorum 3

where such authority involves in its nature the exercise of judgment of the highest character. *Caldwell v. Mutual Reserve Fund Life Ass'n* (1 Dept. 1900) 53 A.D. 245, 65 N.Y.S. 826.

**1. Construction and application**

Under this section, corporation may be bound by promises made by officers and committee members within apparent authority. *Shear v. National Rifle Ass'n of America*, C.A.D.C.1979, 606 F.2d 1251, 196 U.S.App.D.C. 344. *Corporations And Business Organizations* ⇨ 2315

Members of an executive committee have no right to vote compensation to themselves for attendance at the committee meetings, in the absence of express authority permissive of such action. *Marshall v. Industrial Federation of America*, 1903, 14 N.Y. Ann. Cas. 100, 84 N.Y.S. 866.

The New York city public development corporation does not have authority to delegate the approval of real property transactions to the executive committee or another standing committee of the board of directors. *Op. Atty. Gen. (Inf.)* 88-35.

**3. Quorum**

Where nothing appears in the by-laws or in the evidence in a case as to the number of the executive committee necessary to constitute a quorum a majority will be sufficient. *Marshall v. Industrial Federation of America*, 1903, 14 N.Y. Ann. Cas. 100, 84 N.Y.S. 866. *Corporations And Business Organizations* ⇨ 1799

**2. Delegation of authority**

An executive committee cannot delegate authority to one of its members

**§ 712-a. Audit oversight**

(a) The board, or a designated audit committee of the board comprised solely of independent directors, of any corporation required to file an independent certified public accountant's audit report with the attorney general pursuant to subdivision one of section one hundred seventy-two-b of the executive law shall oversee the accounting and financial reporting processes of the corporation and the audit of the corporation's financial statements. The board or designated audit committee shall annually retain or renew the retention of an independent auditor to conduct the audit and, upon completion thereof, review the results of the audit and any related management letter with the independent auditor.

(b) The board, or a designated audit committee of the board comprised solely of independent directors, of any corporation required to file an independent certified public accountant's audit report with the attorney general pursuant to subdivision one of section one hundred seventy-two-b of the executive law and that in the prior fiscal year had or in the current fiscal year reasonably



**N.C. Gen. Stat. § 58-10-210**

Statutes current through the 2014 Regular Session

**General Statutes of North Carolina > CHAPTER 58. INSURANCE > ARTICLE 10. MISCELLANEOUS INSURER FINANCIAL PROVISIONS > PART 7. ANNUAL FINANCIAL REPORTING**

**§ 58-10-210. Qualifications of independent certified public accountant**

- (a) The Commissioner shall not recognize a person or firm as a qualified independent certified public accountant if the person or firm:
  - (1) Is not in good standing with the North Carolina State Board of Certified Public Accountant Examiners and in all other states in which the accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered accountant; or
  - (2) Has either directly or indirectly entered into an agreement of indemnity or release from liability, collectively referred to as indemnification, with respect to the audit of the insurer.
- (b) Except as otherwise provided in this Part, the Commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the AICPA and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of the North Carolina State Board of Certified Public Accountant Examiners or similar code.
- (c) A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a delinquency proceeding commenced against the insurer under Article 30 of this Chapter, the mediation or arbitration provisions shall operate at the option of the statutory successor.
- (d) Lead Audit Partner Rotation Required.
  - (1) The lead or coordinating audit partner, having primary responsibility for the audit, may not act in that capacity for more than five consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five consecutive years. An insurer may apply to the Commissioner for relief from the rotation requirement on the basis of unusual circumstances. This application shall be made at least 30 days before the end of the calendar year. The Commissioner may consider any of the following factors in determining if the relief should be granted:
    - a. The number of partners, expertise of the partners, or the number of insurance clients in the currently registered firm.
    - b. The premium volume of the insurer.
    - c. The number of jurisdictions in which the insurer transacts business.
  - (2) The insurer shall file, with its annual statement filing, the approval for relief granted pursuant to subdivision (1) of this subsection with the states in which it is licensed or doing business and with the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format.
- (e) The Commissioner shall neither recognize as a qualified independent certified public accountant, nor accept an annual audited financial report prepared, in whole or in part, by a natural person who meets any of the following criteria:
  - (1) The person has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, [18 U.S.C. §§ 1961](#) to 1968k, or any dishonest conduct or practices under federal or state law.
  - (2) The person has been found to have violated the insurance laws of this State with respect to any previous reports submitted under this Part.

## N.C. Gen. Stat. § 58-10-210

- (3) The person has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this Part.
- (f) The Commissioner may, as provided in [G.S. 58-2-50](#), hold a hearing to determine whether an independent certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not qualified for purposes of expressing his or her opinion on the financial statements in the annual audited financial report made pursuant to this Part and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this Part.
- (g) Independence of Services.
- (1) The Commissioner shall not recognize as a qualified independent certified public accountant nor accept an annual audited financial report prepared, in whole or in part, by an accountant who provides to an insurer, contemporaneously with the audit, any of the following nonaudit services:
- a. Bookkeeping or other services related to the accounting records or financial statements of the insurer.
  - b. Financial information systems design and implementation.
  - c. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports.
  - d. Actuarially oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions, and inputs used in the determination of amounts recorded in the financial statement only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification on an insurer's reserves if all of the following conditions have been met:
    1. Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions.
    2. The insurer has competent personnel, or engages a third-party actuary to estimate the reserves for which management takes responsibility.
    3. The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves.
  - e. Internal audit outsourcing services.
  - f. Management functions or human resources.
  - g. Broker or dealer, investment adviser, or investment banking services.
  - h. Legal services or expert services unrelated to the audit.
  - i. Any other services that the Commissioner determines, by administrative rule, are impermissible.
- (2) In general, the principles of independence with respect to services provided by the qualified independent certified public accountant are largely predicated on three basic principles, violations of which would impair the accountant's independence. The principles are that the accountant cannot function in the role of management, cannot audit his or her own work, and cannot serve in an advocacy role for the insurer.
- (h) Insurers having direct written and assumed premiums of less than one hundred million dollars (\$ 100,000,000) in any calendar year may request an exemption from subdivision (1) of subsection (g) of this section. The insurer shall file with the Commissioner a written statement discussing the reasons why the insurer should be exempt from these provisions. If the Commissioner finds, upon review of this statement, that compliance with this Part would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.
- (i) A qualified independent certified public accountant who performs the audit may engage in other nonaudit services, including tax services, that are not described in subdivision (1) of subsection (g) of this section or that do not conflict with the principles set forth in subdivision (2) of subsection (g) of this section, only if the activity is

approved in advance by the audit committee, in accordance with subsection (j) of this section.

- (j) All auditing services and nonaudit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the audit committee. The preapproval requirement is waived with respect to nonaudit services if the insurer is a SOX-compliant entity or is a direct or indirect wholly owned subsidiary of a SOX-compliant entity or all of the following apply:
- (1) The aggregate amount of all such nonaudit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the nonaudit services are provided.
  - (2) The services were not recognized by the insurer at the time of the engagement to be nonaudit services.
  - (3) The services are promptly brought to the attention of the audit committee and approved before the completion of the audit by the audit committee or by one or more members of the audit committee who are the members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.
- (k) The audit committee may delegate to one or more designated members of the audit committee the authority to grant the preapprovals required by subsection (j) of this section. The decisions of any member to whom this authority is delegated shall be presented to the full audit committee at each of its scheduled meetings.
- (l) Cooling-Off Period.
- (1) The Commissioner shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer was employed by the independent certified public accountant and participated in the audit of that insurer during the one-year period preceding the date that the most current statutory opinion is due. This section shall only apply to partners and senior managers involved in the audit. An insurer may apply to the Commissioner for relief from this requirement on the basis of unusual circumstances.
  - (2) The insurer shall file, with its annual statement filing, the approval for relief granted pursuant to subdivision (1) of this subsection with the states in which it is licensed or doing business and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format.

## History

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[2009-384, s. 1.](#)

### Annotations

## Research References & Practice Aids

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### CROSS REFERENCES. --

As to exemptions to, and effective dates for, Part 7 of Article 10 of Chapter 58 ([G.S. 58-10-185](#) et seq.), see [G.S. 58-10-260](#).

General Statutes of North Carolina

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## N.C. Gen. Stat. § 116B-8

Statutes current through the 2014 Regular Session

*General Statutes of North Carolina* > **CHAPTER 116B. ESCHEATS AND ABANDONED PROPERTY**  
> **ARTICLE 1. ESCHEATS**

### **§ 116B-8. Employment of persons with specialized skills or knowledge.**

The Treasurer may employ the services of such independent consultants, real estate managers and other persons possessing specialized skills or knowledge as the Treasurer deems necessary or appropriate for the administration of this Chapter, including valuation, maintenance, upkeep, management, sale and conveyance of property and determination of sources of unreported abandoned property. The Treasurer may also employ the services of an attorney to perform a title search or to provide an accurate legal description of real property which the Treasurer has reason to believe may have escheated. Persons whose services are employed by the Treasurer pursuant to this section to determine sources and amounts of unreported property are subject to the same policies, including confidentiality and ethics, as employees of the Department of State Treasurer assigned to determine sources and amounts of unreported property. If the Treasurer contracts with any other person to conduct an audit under this Chapter, the audit shall not be performed on a contingent fee basis or any other similar method that may impair an auditor's independence or the perception of the auditor's independence by the public. Notwithstanding the preceding sentence, the Treasurer may contract with any other person on a contingent fee basis to conduct audits of life insurance companies where the audit is being conducted for the purpose of identifying unclaimed death benefits or to conduct audits of holders of unredeemed bond funds. Compensation of persons whose services may be employed pursuant to this section on a contingent fee basis shall be limited to twelve percent (12%) of the final assessment.

### **History**

1979, 2nd Sess., c. 1311, s. 1; [1999-460, ss. 3\(b\), 5](#); [2012-152, s. 3](#); [2012-194, s. 61.5\(a\), \(b\)](#).

### **Annotations**

### **Notes**

#### **EDITOR'S NOTE. --**

Session Laws [1999-460, s. 3\(b\)](#), provides that 116B-27 is recodified as [G.S. 116B-5](#) within Article 1 of Chapter 116B of the General Statutes. [G.S. 116B-36](#) is recodified as [G.S. 116B-6](#) within Article 1 of Chapter 116B of the General Statutes. [G.S. 116B-37](#) is recodified as [G.S. 116B-7](#) within Article 1 of Chapter 116B of the General Statutes. [G.S. 116B-47](#) is recodified as [G.S. 116B-8](#) within Article 1 of Chapter 116B of the General Statutes.

Session Laws [1999-460, s. 13](#), contains a severability clause.

Session Laws [2012-152, s. 6](#), as amended by Session Laws [2012-194, s. 61.5\(b\)](#), made the amendments to this section by Session Laws [2012-152, s. 3](#), effective October 1, 2012, and further provided that: "The Treasurer shall not renew any contingency fee-based contracts for these services after October 1, 2012. The Treasurer shall not assign further audits on a contingency fee basis to an auditing firm under a contract that meets all the following conditions: (i) the contract would have been prohibited under this act had the contract been entered into after October 1, 2012, and (ii) the contract allows the assignment of audits on a discretionary basis by the Treasurer."

#### **EFFECT OF AMENDMENTS. --**

Session Laws [2012-152, s. 3](#), effective October 1, 2012, deleted the former last sentence, which read: "Compensation of persons whose services are employed pursuant to this section on a contingent fee basis shall be limited to twelve percent (12%) of the final assessment" and added the fourth and fifth sentences. For effective date and applicability, see editor's note.

N.C. Gen. Stat. § 116B-8

Session Laws [2012-194, s. 61.5\(a\)](#), effective July 17, 2012, added the sixth sentence.

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