Simpson Thacher

Memorandum

Auditor-Related Considerations for 20-F Filers Involved in Government Investigations

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In recent years, a significant number of Latin American, Asian and European companies have been caught up in investigations and enforcement actions involving alleged payments to government officials and executives at state-owned companies. When the company that is the subject of such a government investigation is a foreign private issuer with securities listed in the United States, it is particularly important for the company to take a considered and thoughtful approach to interactions with its auditor as the auditor seeks to gain its own understanding of the nature and scope of any misconduct. In particular, a company that is subject to the reporting requirements of the U.S. Securities and Exchange Commission (the "SEC"), including the requirement to file an annual report on Form 20-F, must stay focused on the importance of obtaining an unqualified audit opinion.[1]

Without such an opinion, a company will not be able to file a 20-F that meets the relevant SEC requirements. And an extended delay in the filing of a 20-F will ultimately lead to the company being delisted, with its attendant consequences: a decrease in the price of the issuer's ADSs and underlying shares, civil litigation on the heels of any such significant price drop, covenant defaults, etc. With that in mind, we set forth a list of considerations for a 20-F filer when interacting with the company's auditor in the midst or aftermath of a government investigation or enforcement action.

[1] Many of the considerations set forth herein are also likely applicable to non-20-F filers—as the failure to obtain an unqualified audit opinion may trigger covenant breaches, civil liability and delisting proceedings in their home countries.

List of Considerations

1. **Frequent, transparent communications with the company's auditor are important.** While a company may want to carefully guard the details of its own review of the conduct at issue, it must remain mindful of the auditor's need to obtain a sufficient understanding of the conduct's potential effects on the three years of financial statements included in the company's 20-F, its relevance to the company's internal control over financial reporting, and its implications for the auditor's reliance on representations by company management. It is important for the company to tell the auditor what it plans to do to address any concerns, as well as to provide regular, substantive updates on the company's work. While it is of course helpful to memorialize oral communications with the auditor, there is no substitute for meaningful dialogue. Consider also seeking assurances that the auditor is communicating meaningful issues to responsible executives in supervisory roles.

2. **Consider the utility of objective outside counsel, who report to the Audit Committee or a Special Committee of the Board of Directors, to perform a review of the underlying allegations.** It is crucial for the auditor to understand that the company's review is credible and thorough. The company's interests and the interests of its auditor are generally aligned in having the review identify wrongdoing and wrongdoers. Although the decision to retain outside counsel to carry out a review is often informed by the desire to establish credibility before regulatory and prosecutorial authorities (and the market), the auditor will often seek assurances that the fact finding is conducted by sufficiently objective counsel. Of course, the decisions whether a Board committee or management should oversee a review conducted by outside counsel, and who that counsel should be, are fact-specific and depend on multiple factors. These include whether the company's regular outside counsel gave advice on, or was otherwise involved in, the alleged conduct, whether the alleged conduct implicates the C-suite, and the capabilities of the relevant Board committee to manage a complex investigation. Officers or directors responsible for overseeing the review should not have any connection to the alleged wrongdoing (and, ideally, would not have been at the company at the time of the alleged wrongdoing).

3. **Ensure that those in management and on the Board making representations to the company's auditor are not implicated in the alleged wrongdoing**. If an employee or director responsible for making representations to the auditor is implicated in the wrongdoing, additional precautions should be taken. For example, to avoid a delay in the company's 20-F filing (and the risk that any previously issued audit opinions be withdrawn), the company may wish to expedite its review of the employee's or director's alleged involvement in any wrongdoing. The company also may consider identifying additional representatives who can make similar representations. Timely engagement with the auditor on this topic is especially crucial.

4. **Engage with the auditor on the scope of the company's review**. The auditor typically will wish to have an opportunity to comment on the review's scope and significant steps. That certain avenues of fact-finding may be cumbersome or time-consuming likely will not be persuasive to the auditor if the auditor believes those avenues could be helpful or necessary in obtaining information relevant to its audit. It will therefore be important to explain to the auditor substantively why a suggested avenue of fact-finding can either be narrowed or eliminated. While, at the end of the day, the company's review is the *company's* and should not and cannot be directed by the auditor, the reality is that the auditor will not issue an unqualified audit opinion unless the auditor determines that it has satisfied its own professional obligations in exercising due care and obtaining and evaluating sufficient audit evidence. As a result, the line between appropriate questions and challenge from an auditor on the one hand, and inappropriate directions and influence from the auditor on the other, is not always a bright one.

5. **Be pragmatic with respect to navigating the attorney-client privilege and work product protection**. While the company and its counsel should navigate attorney-client privilege and work product protection issues with care, that navigation must be done with an eye on the importance of obtaining an unqualified audit opinion. Auditors are generally willing to work with companies to minimize the risk of a privilege or work product protection waiver, but not at the expense of being denied access to information they view as critical to meeting their professional obligations. A company ordinarily should be able to convey necessary *factual* information to its auditor without handing over written attorney work product or unduly risking a privilege waiver. (It is worth noting that, while there is a split of authority in the United States, a majority of courts have found there to be no waiver of the work product protection when providing substantive updates on internal investigations to a company's auditor because an auditor is generally deemed not to be adverse to the company.) To the extent that the communication of such information leaves a residual risk of a waiver, the consequences of a potential delisting from a U.S. exchange often will mean finding a way to share the necessary information.

6. **Be sensitive to the auditor's liability concerns**. Auditors are governed by their own sets of professional responsibility rules and auditing standards. U.S. audit firms are subject to examinations by the Public Company Accounting Oversight Board ("PCAOB"), and can be sanctioned by the PCAOB, the SEC and the U.S. Department of Justice. When an auditor requests information that seems wide-ranging, it is likely doing so to fulfill what it views as its professional obligations. It is important not to be dismissive of such requests and to work with the auditor to understand why the auditor is seeking the information, and to determine whether there is a less burdensome way of meeting the auditor's needs.

7. **Consider impact of delayed SEC filings**. If a company realizes it will need to delay filing its 20-F while the auditor works to assess information and complete its audit, it will be important to make sufficient disclosure to the market of the anticipated delay. Be sure that representatives of the company are accurate and complete in their public statements regarding the delay. The company should proactively work with its exchange to obtain an extension to become compliant with the exchange's listing standards (i.e., by filing its delayed 20-F), and then work expeditiously to meet any extension to avoid being delisted.

8. **Consider feasibility of a replacement auditor**. At a certain point, the company may need to engage a suitable replacement auditor. This is not ideal for a number of reasons, including because it will add to the time it takes to complete the audit. Further, the audit of the company's internal control over financial reporting will be more challenging to conduct when an auditor is engaged after the fiscal year at issue. The company will need to disclose the reason for the change in auditor and ensure that the new auditor meets the SEC's auditor independence requirements. Because of those requirements, when engaging an audit firm (or its affiliate) for non-audit work, a company should consider that doing so may leave the company with fewer options in the event it is looking for a replacement auditor.

While a 20-F filer facing a government investigation typically will be consumed with the government investigation and its own related review, the company will want to be deliberate in its interactions with its auditor to avoid a further hurdle down the road. Assuring that the auditor is kept apprised and has input into the company's investigative work will not avoid the real challenges presented if the identified wrongdoing materially affects the company's financial statements and the credibility of the company's management, but it may help facilitate resolution of these issues and limit the breadth of their impact.

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