



Oversight of special investigations

On March 17–18, 2016, members of the North American Audit Committee Leadership Network (ACLN) met in New York for their 32nd meeting. In one session, they were joined by Bart Friedman, a senior partner at the law firm of Cahill Gordon & Reindel. For a biography of Mr. Friedman, see Appendix 1, on page 13. For a full list of participants, see Appendix 2, on page 14.

Executive summary

In conversations both before and during the meeting, Mr. Friedman and ACLN members touched on several aspects of overseeing a special investigation:¹

- **The challenging government enforcement environment** (*page 2*)

Heightened prosecutorial attention to corporate conduct has caused audit committee chairs to launch investigations of a number of different issues. In particular, ACLN members called out governmental pursuit of Foreign Corrupt Practices Act (FCPA) violations, scrutiny of financial reporting, and emphasis on individual liability – including for gatekeepers such as auditors and board directors – as reasons for this attention. Government incentives for whistleblowers have made it even more important that companies stay on top of these issues.

- **Launching an investigation** (*page 4*)

Several types of allegations may prompt a board to launch an investigation, including financial irregularities, allegations against senior management or directors, and government enforcement matters. Though allegations that represent an existential threat to the company may require a special committee, the audit committee will typically oversee an investigation by the board. Mr. Friedman argued that more serious cases should prompt the audit committee to hire outside counsel, chosen for its independence from the company, its credibility with the government, its expertise and temperament, and the rapport between the outside counsel and the audit committee.

- **Managing an investigation** (*page 7*)

Members were interested in how to keep the scope of an investigation under control. Mr. Friedman recommended comparing outside counsel's fees with those of the other lawyers involved (such as those hired by management), and he and the members emphasized the importance of ongoing dialogue between the audit committee and counsel. Communication with other board members and senior management is also important, but counsel should be involved in order to preserve privilege. Counsel should also build a relationship with the external auditor, based on transparency and trust, since the auditor is a key participant in this process. Mr. Friedman and members generally agreed that an investigation should only be concluded when every allegation has been thoroughly examined.

¹ *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members and guests in connection with the meeting.

- **Communicating to external stakeholders** (page 10)

Despite the ACLN members' reservations, Mr. Friedman argued that self-reporting to the government is generally the safest approach for the audit committee. The government is likely to learn about a serious issue from other sources, and the consequences for audit committee members would then be dire.

Transparency with shareholders is also important, and Mr. Friedman reminded the members that disclosures to shareholders are carefully scrutinized by the Securities and Exchange Commission (SEC).

For a list of discussion questions for audit committees, see Appendix 3, on page 15.

The challenging government enforcement environment

In recent years, the government has increasingly targeted corporations, as well as their executives and directors, in enforcement efforts. For example, Attorney General Loretta Lynch's first major policy statement was to announce a push to prosecute white-collar defendants.² Likewise, SEC chair Mary Jo White, herself a former federal prosecutor, has made enforcement a priority. In Congressional testimony delivered last year, she said, "A strong and effective enforcement program is at the heart of the SEC's efforts to protect investors and instill confidence in the integrity of the markets ... Successful enforcement actions impose meaningful sanctions on securities law violators, result in penalties and disgorgement of ill-gotten gains that can be returned to harmed investors, and deter wrongdoing."³

This environment has led boards to prioritize special investigations in an effort to uncover and address problems before they become the object of government attention. At the same time, Mr. Friedman noted that investigations will always be important, regardless of the environment in Washington: "*Whoever becomes president of the United States, and whoever winds up in control of the House or the Senate, the fact-based decisions that the audit committee must make in investigations should not be viewed through the prism of politics. Presidents come and go, but the fiduciary responsibilities, reputational ramifications, and legal complexities attendant to investigations will not likely change whoever sits in the White House.*"

Three areas of government enforcement focus were of particular interest to audit chairs:

- **Foreign Corrupt Practices Act.** The Justice Department has made prosecuting FCPA violations a priority. According to spokesman Peter Carr, "The department is increasing its FCPA resources, and the three new FBI squads focusing on this issue are now staffed and operational."⁴ In a 2015 speech, Andrew Ceresney, director of the Division of Enforcement at the SEC,⁵ explained why the SEC is also interested in pursuing these cases: "Pursuing FCPA violations is a critical part of our enforcement efforts. International bribery has many nefarious impacts, including sapping investor confidence in the legitimacy of a company's performance, undermining the accuracy of a company's books and records and the

² Matt Apuzzo and Ben Protess, "[Justice Department Sets Sights on Wall Street Executives.](#)" *New York Times*, September 9, 2015.

³ Mary Jo White, "[Testimony on 'Examining the SEC's Agenda, Operations and FY 2016 Budget Request'](#)" (US House of Representatives Committee on Financial Services, Washington, DC, March 24, 2015).

⁴ Stephen Dockery, "[DOJ Says Pursuing 'Higher-Impact' Bribery Cases.](#)" *Risk & Compliance Journal* (blog), *Wall Street Journal*, October 5, 2015.

⁵ In a separate session, also on March 18, 2016, members were joined by Mr. Ceresney for an off-the-record discussion about SEC enforcement priorities and trends.

fairness of the competitive marketplace.”⁶ The increased scrutiny on FCPA issues creates a risk for doing business in certain markets. According to EY’s 2015 Europe, Middle East, India, and Africa fraud survey, fraud is still a problem in many parts of the world: “More than half of all respondents, and 61% of respondents in rapid-growth markets, believe that bribery and corruption is widespread in their country. And yet 42% of respondents report that their company does not have an anti-bribery policy in place or didn’t know if there was one.”⁷ Mr. Friedman cautioned members that because FCPA is a criminal statute, boards should demonstrate heightened interest when investigating an alleged violation.

- **Financial reporting.** In a recent speech, Mr. Ceresney explained the government’s focus on prosecuting cases related to companies’ financial reports: “Comprehensive, accurate, and reliable financial reporting is the bedrock upon which our markets are based ... The Commission is committed to holding accountable those whose actions prevent investors from receiving timely and reliable information that enables them to make informed investment decisions.”⁸ ACLN members were also concerned about cases regarding internal controls over financial reporting. Mr. Ceresney pointed out that the SEC has “brought charges for violations of the internal accounting controls provisions of the federal securities laws, even in the absence of fraud charges.”⁹ In addition to its cases against corporate issuers and executives, the SEC has pursued cases against external auditors for failing to adequately audit financial statements. Last year, the SEC brought actions against audit firms BDO and Grant Thornton, along with individual auditors from those firms, in its first cases against national audit firms for audit failures since 2009.¹⁰
- **Individual liability.** In a memorandum last year, the Justice Department said it would prioritize prosecuting individual defendants when it pursues cases of corporate malfeasance. Deputy Attorney General Sally Yates explained, “It’s only fair that the people who are responsible for committing those crimes be held accountable. The public needs to have confidence that there is one system of justice and it applies equally regardless of whether that crime occurs on a street corner or in a boardroom.”¹¹ The SEC, too, is emphasizing individual liability.¹² Part of this focus includes the scrutiny of gatekeepers, including board directors. Mr. Ceresney recently said that while the SEC does not frequently prosecute audit committee members, there have been some recent exceptions: “The takeaway from these cases is straightforward: when an audit committee member learns of information suggesting that company filings are materially inaccurate, it is critical that he or she take concrete steps to learn all relevant facts and cease annual and quarterly filings until he or she is satisfied with the accuracy of future filings.”¹³

⁶ Andrew Ceresney, “[FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry](#)” (speech, CBI’s Pharmaceutical Compliance Congress, Washington, DC, March 3, 2015).

⁷ EY, *Fraud and Corruption – The Easy Option for Growth? Europe, Middle East, India and Africa Fraud Survey 2015* (London: EYGM Limited, 2015), 1.

⁸ Andrew Ceresney, “[Directors Forum 2016 Keynote Address](#)” (San Diego, CA, January 25, 2016).

⁹ [Ibid.](#)

¹⁰ [Ibid.](#)

¹¹ Matt Apuzzo and Ben Protess, “[Justice Department Sets Sights on Wall Street Executives](#).”

¹² Andrew Ceresney, “[Keynote Speech at New York City Bar 4th Annual White Collar Institute](#)” (New York, May 12, 2015).

¹³ Andrew Ceresney, “[Directors Forum 2016 Keynote Address](#).”

Another trend that has led boards to pay greater attention to investigative issues is the prevalence of whistleblower claims. In 2011, the SEC adopted whistleblower rules mandated under the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules state that a person who informs the SEC about a securities law violation is eligible for a bounty of between 10% and 30% of the sanctions collected for the violation.¹⁴ In 2015, the SEC received nearly 4,000 whistleblower tips and paid awards totaling over \$37 million to whistleblowers.¹⁵ In a speech last year, Chair White said, “It is past time to stop wringing our hands about whistleblowers. They provide an invaluable public service, and they should be supported. And, we at the SEC increasingly see ourselves as the whistleblower’s advocate.”¹⁶

Launching an investigation

After electing to launch an investigation, directors must decide what committee of the board should lead the investigation, whether the investigation will require outside counsel, and how outside counsel should be chosen.

Deciding whether to launch a board investigation

Members said that it can be challenging for directors to determine which allegations, sourced from hotline calls, government inquiries, press reports, internal audit findings, and elsewhere, should prompt the board to initiate an investigation, but they brought up several scenarios that often will do so:

- **Financial irregularities.** Allegations of fraud or other misconduct relating to the company’s financials almost always trigger an independent investigation by the board. These might include, for example, improper accounting for business activities, like manipulation of earnings, or falsified books and records.¹⁷
- **Allegations against senior management.** When the problems involve the highest levels of the organization, it is incumbent upon the board to oversee the investigation. In a pre-meeting conversation, one member said, *“If the problem is systemic, or somehow enabled by management, or should have been discovered in the usual course by management, you decide to do a deeper dive to see if there is a bigger problem ... if something was enabled or caused by a bigger organizational issue.”*
- **Allegations against a director.** Some members mentioned having to investigate their fellow board members. One member said, *“I have been involved in a series of investigations regarding director behavior. They typically came from an internal whistleblower and involved issues such as sexual misbehavior, sharing material information with a shareholder, and sharing competitively sensitive information with a competitor.”*
- **Government enforcement matters.** Members said that allegations that could result in a significant government enforcement inquiry often lead the board to conduct an investigation. In particular, they

¹⁴ “Frequently Asked Questions,” SEC Office of the Whistleblower, accessed February 17, 2016.

¹⁵ US Securities and Exchange Commission, *2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program* (Washington, DC: US Securities and Exchange Commission, 2015), 1.

¹⁶ Mary Jo White, “The SEC as the Whistleblower’s Advocate” (speech, Ray Garrett, Jr. Corporate and Securities Law Institute-Northwestern University School of Law, Chicago, April 30, 2015).

¹⁷ Frank M. Placenti et al., *The Audit Committee’s Evolving Role in Overseeing Corporate Investigations* (Squire Sanders and EY, 2013), 4.

mentioned criminal investigations into allegations of bribery, for example in the context of a potential FCPA case, as an area that requires board-level attention.

In a pre-meeting conversation, EY expert Brian Loughman underscored the importance of thinking through beforehand how the decision to launch an investigation will be made: *“There is no substitute for judgment, but I do think that clients should have pre-thought-out filtering systems. It helps you drive a process so that when you’re subjected to hindsight, you can say, ‘We have a process with decision criteria.’”* He noted that directors should consider a number of questions before an issue arises: *“Who have we entrusted to make these decisions? The general counsel? Do we have the right relationship with the person? There is often a strong relationship between the audit committee and the general counsel. What’s the protocol for getting more information?”*

Determining board leadership

Once the decision to go forward with an investigation is made, the board must decide who should take the lead. ACLN members mentioned two different potential leaders for an investigation:

- **The audit committee.** Members said that audit committees typically lead investigations because the allegations that trigger an investigation often fall under the audit committee’s purview. In a pre-meeting conversation a member said, *“The bias is towards audit committee oversight, even if you make the audit committee the special committee, because this is the responsibility of the audit committee. It seems to me that it is one of the primary roles of an audit committee and the audit committee chair.”*

At the meeting, Mr. Friedman said, *“In the rare cases that you have an allegation against senior management, evidence of systemic or repeated accounting irregularities, a violation of the code of conduct by an officer of the company, a criminal allegation, or something that creates reputational risk, the audit committee is usually the right group to handle the investigation.”* He added, *“The audit committee members are chosen because of their substantive skills, and audit committees have to work collaboratively.”*

- **A special committee.** Some cases warrant enough attention for the board to create a special committee to provide oversight. In a pre-meeting conversation, a member said, *“One reason to choose a special committee: the severity of the issue or the level of senior management you have to deal with. If it’s life-threatening to the company, a special committee is more appropriate.”* Mr. Friedman added, *“There are times when the entire audit committee signed off on something, so the board decides to set up a special committee. It depends on the specific facts.”*

Electing to hire outside counsel

In some cases, the board can utilize a company’s internal resources to conduct an investigation. Depending on the allegations involved, directors would work with the internal audit staff or members of the legal department to conduct an internal inquiry. One member explained, *“Some things are right in the sweet spot of the audit committee. It’s important for the audit committee to be able to handle a lot of these things*

through the company's internal structure.” Another member said, “In some cases, management does the investigation, and we just oversee it.”

However, as Mr. Friedman made clear in the meeting, the audit committee should strongly consider outside counsel for its investigations, especially in cases of allegations against senior management, accounting irregularities, and criminal allegations: *“In those cases, reach out to external counsel. Protect yourself. The SEC may be looking for a gatekeeper to punish. As a result, the audit chair has to be very careful about how to handle investigations. A director may not want to contact the GC [general counsel] in the first instance where there is allegedly inappropriate conduct by senior management. The GC can be conflicted in certain cases. The GC is the senior management team's lawyer, not the audit chair's lawyer. It's important to reach out to outside counsel. It's the safest thing for the audit chair to do.”*

ACLN members acknowledged the point but also noted that the decision can be complicated when time is of the essence. One member gave an example: *“Sometimes time matters very much – for example, if the company is facing allegations that earnings have been managed but the CFO has announced his departure. The timing requires us to get to the bottom of it immediately. We're on the phone 24/7 – we don't have time to engage outside counsel. It's important to get to the bottom of it before the company announces earnings. After that, we bring in outside counsel for all the reasons you touch on. It is part of the reality that some of us have to deal with sometimes. A ‘when to,’ not a ‘whether to.’”*

When a member brought up the question of how much directors and officers (D&O) insurance coverage directors should have, Mr. Friedman noted that getting outside review of D&O coverage is not only advisable but also an opportunity for the board or the audit committee to begin building a relationship with an outside lawyer: *“Maybe you start the relationship with counsel to look at the coverage. Be aware that coverage could evaporate based on certain provisions. Some of these policies are not as good as they can be, but they are subject to negotiation.”*

Selecting the right outside counsel

Mr. Friedman and the members discussed the criteria that are important in selecting outside counsel, including concrete, measurable variables and more subjective ones:

- **Independence.** Mr. Friedman explained the importance of independence: *“The audit committee should not have a law firm that has done anything more than minimal business for the company in the past. You want a level of purity. This is critical if you go and meet with the government, because the government wants to make sure the lawyer is beholden to the audit committee and not the company. Get a list from a trusted adviser, run conflict checks, and speak to them with the other audit committee members.”* When asked about getting assistance from the GC, he said, *“You typically don't want to retain someone recommended by the GC. You want the lawyer to know that you, as the audit chair, are responsible for their hiring, not the GC. It's critical – you want to be the person who makes the hire, who manages the relationship and who gets blunt and objective advice.”*
- **Expertise.** Mr. Friedman said, *“Get the subject matter expertise you need. It might be experience in a particular geographic region, for example.”* Again, sending a signal to the government is important:

“The government will say this is somebody with serious credentials – you can trust their conclusions.”

As a member suggested, the right expertise can establish credibility in the eyes of the internal stakeholders as well: *“In one case, we wanted someone who was very strong, with a tremendous track record working on [merger-and-acquisition] investigations. They worked well with both the special committee and the management team. They were able to put everybody in their place.”*

- **Temperament.** At the same time, a member suggested that there is a certain authority that goes beyond expertise: *“You need to have a person with gravitas, who has a steady hand on the wheel. There are a lot of constituents, so it is key to have someone who can de-escalate problems.”*
- **Rapport.** Mr. Friedman emphasized that the outside counsel must absolutely be someone with whom you can build the right relationship – characterized first and foremost by honesty: *“It should be someone who will be blunt and push back at you, a relationship with dialogue on substantive issues. You want there to be a conversation, not just someone telling you what to do. The pushback should go both ways. Results are better when you hire someone who is your peer, not someone who tells you what to do, or always says yes.”* He added, *“It’s an intensely personal relationship. This is your lawyer – you need them to make a commitment to you. When this is an existential threat to your career, it becomes a personal issue with whomever you hire.”*

Several members and experts raised the question of whether a legal team should be identified in advance to ensure a swift response. One member who had been involved in a series of investigations said, *“As a result of my experience, when I am audit committee chair, I always line up independent counsel and make sure someone is available to me before there is a problem. We need to move quickly, so we need those arrangements made ahead of time. I develop a preexisting relationship with outside counsel.”*

In a pre-meeting conversation, Mr. Friedman reflected, *“My instinct is to tailor the choice of counsel to your particular problem. The best solution is a lawyer with corporate expertise and litigation expertise, along with a team that would have credibility with the government investigators. But you would consider different groups ... I don’t know if I would choose someone in advance. The nature of counsel may depend on the problem that comes up.”* At the meeting, he made a similar point: *“A relationship is helpful, as long as you are willing to go to someone else if you need specialized expertise. Unique statutes, for example, may require you to use someone other than the counsel you might have lined up.”*

Managing an investigation

Members described a number of challenges that the board and audit committee must confront once an investigation formally begins. These included managing the scope of the investigation and communicating with the other directors, members of management, and the external auditor.

Managing the scope

Members were especially interested in controlling the scope of an investigation: *“We are not lawyers, we don’t typically do investigations. How do we supervise the law firm so we don’t get a platinum-plated outcome, but a good outcome with good value for the shareholders?”*

In a pre-meeting conversation, Mr. Loughman emphasized that as an investigation gets under way, it is critical to establish clear objectives supported by good communication among the participants: *“Whether it’s a special committee or the audit committee itself overseeing the investigation, there needs to be uniformity of purpose, alignment around what you want to achieve. We often see a disparity in what members view as the endgame ... It goes sideways if there is a lack of clarity, a lack of communication. If you have good communication, qualified people will steer it in the right direction.”*

One member said that this dialogue is particularly important when the scope of the investigation changes: *“When things change, you have to ask questions. There should be a lot of discussion. Expanding the scope costs money and time, and brings distractions. Any new work stream has to be established and approved by the audit committee. You can’t outsource the investigation to outside counsel. It’s hard to control and pull back in. You need to define the scope and the process. It will change as the facts change, but you have that rich dialogue up front.”*

Mr. Friedman recommended benchmarking against the other lawyers hired: *“You will see the fees and expenses of all of the firms involved, the various levels of lawyers. You can see the scale. If the audit committee’s firm is the highest-billing firm, something is wrong there. You will get detailed bills, and the GC will complain sometimes. But sometimes, when the audit committee is doing the investigation, it can be hard to control. The audit committee chair and the lawyer need to have regular conversations.”* He added that good lawyers have an incentive to be efficient and not overbill because it influences their relationship with their clients and the potential for future business or referrals.

Communicating with management and the board

The importance of good communication extends beyond the circle of immediate participants. Members said it was important for the directors leading the investigation to report to internal constituents on how things are progressing, as appropriate.

- **Other board members.** Mr. Friedman recommended heavy involvement by outside counsel in communications to the board, especially in the early phases of an investigation. Initially, when the audit committee is short on facts, it is best to let counsel take care of the communications. Over time, the audit committee and counsel can conduct joint presentations, and eventually the audit chair will become *“sufficiently educated [to] have the conversation with the board.”* However, Mr. Friedman also noted that having counsel update the board is useful to help ensure that privilege is protected.
- **Senior management.** It is critical for directors to maintain an effective relationship with management during an independent investigation. One ACLN member said, *“You need to communicate at appropriate points with senior management so they are not in the dark.”* However, Mr. Friedman recommended going through the company’s lawyers, again to preserve privilege: *“You and your counsel should work with company counsel, who will sit down and fill [management] in. You want to maintain the privileged nature of communications between the company counsel and management. At the end of the day, they are getting information from a different source.”*

Maintaining relations with the external auditor

Mr. Friedman advocated robust communications with the external auditor to ensure that the external auditor retains faith in the company: *“The external auditor has responsibility to sign off on financial statements, and they rely on reports from senior management. It is my practice to develop a relationship with the external auditor, especially the engagement partner. Be transparent, especially on things related to the integrity of senior management. Sit with the engagement partners and have a transparent conversation. Not on things that are privileged, but on facts. That’s a healthy approach. There may be times where there is a divergence of interest, but it is usually in your interest to maintain that relationship. The death spiral begins if the external auditor won’t sign off on financial statements.”*

An ACLN member from EY added, *“These situations are always difficult and these discussion can become a flash point if not handled well. The auditor has a job to do and if they get a sense that they are not receiving full transparency, they are going to be concerned. If every question is answered with, “that is privileged,” the auditor will become even more skeptical, as they should be. These issues are too important for there not to be complete transparency on the issues.”*

The external auditor may want to conduct its own “shadow investigation” to assess the investigation and monitor its findings.¹⁸ The team conducting the shadow investigation may request timely and detailed updates on the investigation’s work plan and its progress. Keeping this team well informed may allow it to offer input on the scope of the investigation and the procedures involved.

Deciding when to stop

While establishing and communicating clear objectives at the beginning of an investigation can facilitate the process of bringing it to a close, it may still be difficult to determine exactly when the investigation is complete. Members and Mr. Friedman raised this issue in pre-meeting conversations. A member reflected, *“A good question is, how do you know when to stop? [Investigations] have a life of their own – you can dig and dig, but when is enough enough?”*

Members had somewhat varying perspectives on this question. One member agreed that the issue could be challenging but noted that lines still have to be drawn: *“It’s a judgment thing. Check in with outside counsel and provide direction. You need to put some boundaries on them – these are always expensive.”* Another member warned against trying to restrict an investigation too much: *“Don’t even think you’re going to contain it. The attitude to always take: we need to fully understand, get to the bottom, fix – we need to settle it in a comprehensive way.”* Others agreed: *“You wouldn’t stop an internal investigation even if an external one is launched. You want to turn over every rock. If an external one requires an analytical [approach], you may disagree with it and want your own analysis.”*

Mr. Friedman pointed out that a thorough approach protects the reputation of the audit committee members, which includes their faithful service to the company and its interests. Describing his own attitude when serving as audit committee counsel on an investigation, he said, *“I only have one client: the three or*

¹⁸ Frank M. Placenti et al., *The Audit Committee’s Evolving Role in Overseeing Corporate Investigations*, 10–11, 15.

four people on the audit committee. The only way to defend and protect them is to ensure that every allegation is examined.” He acknowledged that *“there are going to be some dead ends,”* but argued that this is unavoidable if you want to ensure that the audit committee members are not criticized later.

The audit committee is often involved in the follow-up activities that take place at the company in the wake of an investigation. One member noted that while remediation is foremost a management responsibility, the audit committee may provide oversight: *“If it’s about improving controls, for example, the audit committee would want management to lay out the remediation plans and the resources committed, and the audit committee would provide oversight that it was being done.”*

Communicating to external stakeholders

Members and Mr. Friedman discussed appropriate practices for communicating about an investigation with those outside the company, including the government and investors.

Self-reporting to the government

Special investigations are often focused on allegations that, if confirmed, constitute legal violations. As an investigation proceeds, it may become evident that the appropriate authorities need to be notified. Yet members believed that the decision to self-report to the government is not always clear-cut. One member remarked, *“We usually conclude that it is good to self-report. However, one case I have been involved in was an FCPA case, and the advice of counsel was not to self-report. This is an area that seems to be different – there may be no perceived benefit in self-reporting.”* Another said, *“The decision to self-report is ultimately a management decision, based on balancing business facts.”*

Mr. Friedman challenged the members’ views, noting that each situation must be judged case-by-case, but there can be reduced risks for the company and its audit committee when a decision is made to self-report: *“If you know about [the misconduct], then people at the company know about it, then the likelihood of someone else reporting it to the government is high.”* He added, *“Companies and their audit committees will not escape criticism from the government if they find out about it and the company did not self-report. There are many reasons why self-reporting may be in the best interest of the company, including that the company will receive cooperation credit.”*

Members said that the government’s lack of transparency about that credit contributes to the difficulty in deciding whether or not to self-report. One said, *“If the government regularized and publicized the benefits it provides to a defendant who self-reports, it might make the decision to self-report easier.”* Members also noted that the issue of cooperation credits can reveal differences between the interests of the board and those of management.

Mr. Friedman was clear that while he frequently encourages directors to self-report the results of their investigations, he is adamantly against having the audit committee chair participate in briefing the government: *“The audit committee chair will never be allowed in the room with the government as long as I am alive. People go to jail for giving inaccurate statements or not well-thought out answers to prosecutors. Nothing good can come from a director walking into the SEC voluntarily.”*

Disclosing to shareholders and the general public

Another issue that companies must face as an investigation unfolds is whether and when to disclose information about the investigation to shareholders and the general public. When there is a choice about whether to disclose, members reported wrestling with the inherent complexity of gauging how these groups will interpret and react to disclosures.

Some companies choose to err on the side of more rather than less disclosure. In a pre-meeting conversation, one ACLN member explained his approach: *“Regarding external communication with employees, shareholders, [and] the public, it’s a difficult balancing act. My bias is toward more transparency rather than less. Usually, there are some obvious checkpoints where you know something that is relevant. Be aware of when you have knowledge of something that is relevant to people who have to make decisions.”* Mr. Friedman saw a reputation risk specifically for directors if disclosures are inadequate: *“The company may not be credited for public disclosures, but a director could be criticized later if something is later reported. Directors need to think hard about their reputations.”*

At the meeting, Mr. Friedman elaborated: *“Be very careful. The SEC is looking very carefully at this – how it gets disclosed, the specific language. Management will find themselves in a bind. The audit committee shouldn’t write the disclosure, but it should weigh in. Every line you write will be scrutinized by the SEC. Be sure it is accurate.”*

Conclusion

Today’s regulatory environment is prompting more board investigations, typically led by the audit committee. For serious issues, such as allegations against senior management, Mr. Friedman recommended hiring carefully selected outside counsel. He and the ACLN members agreed that during the course of an investigation, effective communication with the board, senior management, and the external auditor is key, but Mr. Friedman also argued for full transparency with the government, stressing that self-reporting is generally the safest bet for the audit committee, and while non-reporting may be considered, there has to be a lengthy and carefully considered analysis of the implications of not self-reporting. Mr. Friedman urged the audit chairs to *“recognize that an investigation is a long, painful process. It will be messy. A collaborative process between the audit chair and external counsel is critical to a final resolution.”*



About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

The perspectives presented in this document are the sole responsibility of Tapestry Networks and do not necessarily reflect the views of network members or participants, their affiliated organizations, or EY. Please consult your counselors for specific advice. EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Tapestry Networks and EY are independently owned and controlled organizations. This material is prepared and copyrighted by Tapestry Networks with all rights reserved. It may be reproduced and redistributed, but only in its entirety, including all copyright and trademark legends. Tapestry Networks and the associated logos are trademarks of Tapestry Networks, Inc., and EY and the associated logos are trademarks of EYGM Ltd.



Appendix 1: Biography of Bart Friedman

Bart Friedman is a senior partner at the Wall Street law firm Cahill Gordon & Reindel LLP and is chairman of its business development committee. Mr. Friedman advises leading financial institutions and global corporations, boards of directors, audit committees, and officers and directors of publicly held companies (in the United States and elsewhere) in significant corporate and securities matters, with particular emphasis on corporate compliance and enforcement challenges.

Mr. Friedman has over 30 years of experience advising clients in matters affecting corporate policy and strategy, such as directors' duties and responsibilities and other aspects of corporate governance, including those arising under Sarbanes-Oxley. He is widely regarded for his expertise in accounting disputes and restatements, conflicts of interest, fiduciary responsibilities, liabilities, public disclosures, audits, investigations, and enforcement actions. Mr. Friedman has led and/or served as monitor in numerous transnational investigations involving complex compliance, ethics, and financial-control procedural allegations and scenarios.

Mr. Friedman has represented, or is currently representing, the following companies, members of management, or the independent members of the boards of Abercrombie & Fitch, Bausch & Lomb, Beazer Homes, Cablevision, Centex, Chicago Board Options Exchange, Coca-Cola Enterprises, D.E. Shaw, Estée Lauder, Fortress, Freddie Mac, H&R Block, HSBC, Korn/Ferry International, Molson Coors, Novell, NYMEX, Pfizer, Qualcomm, Wal-Mart Stores, VaxGen, Viacom, Wellcare, and other public companies.

Mr. Friedman serves extensively on boards and in other leadership positions for publicly traded companies, private investment funds, world-renowned think tanks, and prominent educational and art institutions.



Appendix 2: Participants

Members participating in all or part of the meeting sit on the boards of over 25 public companies:

- Mary Anne Citrino, Audit Committee Chair, HP Inc.
- Tim Flynn, Audit Committee Chair, Wal-Mart
- Murry Gerber, Audit Committee Chair, BlackRock
- Mike Losh, Audit Committee Chair, Aon
- Chuck Noski, Audit Committee Chair, Microsoft
- Shonaid Jemmett-Page, Audit Committee Chair, GKN*
- Tom Schoewe, Audit Committee Chair, General Motors
- David Vitale, Audit Committee Chair, United Continental Holdings
- Chris Williams, Board Member, Caesars Entertainment, The Clorox Company, and Cox Enterprises (alumnus)

EY was represented in all or part of the meeting by:

- Steve Howe, US Chairman and Americas Managing Partner
- Frank Mahoney, Americas Vice Chair of Assurance Services

* Member of the European Audit Committee Leadership Network

Appendix 3: Discussion questions

The following questions may stimulate fruitful conversations among audit committee members:

- ? What kinds of issues tend to be investigated by the board?
- ? How does the board select who oversees the investigation?
- ? When does an investigation require the assistance of outside resources?
- ? What criteria should be applied in choosing external resources?
- ? What aspects of an investigation can be planned in advance? What aspects should be decided when the investigation is actually initiated?
- ? What practices and processes have you used to oversee the investigative team? What has worked well? What has not?
- ? How should the directors leading an investigation communicate with internal stakeholders, such as other board members and senior management? How should they communicate with the external auditor?
- ? How do you know when an investigation should be concluded? How can you be sure it is comprehensive but not excessive?
- ? What are best practices for overseeing remedial measures and evaluating their longer-term success?
- ? What factors should be considered when deciding whether to self-report the findings of an investigation to the government?
- ? What factors should be considered when evaluating disclosures to shareholders and the broader public about an ongoing investigation?
- ? Do you evaluate the board's effectiveness in overseeing a concluded investigation? What lessons have you learned from such reviews?