Audit Committee Leadership Network

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ACLN

VIEWPOINTS

The audit committee's role in special investigations

Regulators, shareholders, employees, and the media all look to boards to oversee investigations of major allegations and to resolve issues with integrity. Audit committees often lead these special investigations, which are complex, costly, time consuming, and vital to restoring stakeholder confidence.

On November 11, 2022, members of the Audit Committee Leadership Network (ACLN) met in Washington, DC, to discuss this topic with Sally Yates, partner in King & Spalding's special matters and government investigations practice and leader of the firm's crisis management practice. Ms. Yates had a long and distinguished career in the US Department of Justice (DOJ), serving as deputy attorney general and acting attorney general of the United States.

This *ViewPoints* summarizes important considerations for audit committees that were raised in the session and in premeeting conversations. It is organized around three stages of an investigation:[1]

- **The preliminary inquiry** *(page 1)*
- **Overseeing the investigation** *(page 3)*
- **Concluding the investigation** *(page 8)*

For Ms. Yates's biography, see Appendix 1 (page 11); for a list of meeting participants, see Appendix 2 (page 12); for reflection questions for audit committees, see Appendix 3 (page 13).

The preliminary inquiry

When a company is faced with a significant allegation, it must decide whether the board should lead the investigation and how it should be conducted.

Deciding to launch a board-led special investigation

Allegations may surface through whistleblower hotlines, internal audit findings, press reports, and other sources that alert the board to the potential need for an investigation. All claims should involve some degree of management follow-up but deciding which require board leadership can be challenging. Ms. Yates shared considerations for boards:

- **Determining which issues require board involvement.** *"There are not a lot of hard-and-fast, black-and-white rules,"* she said. *"It is more of a totality of the facts and circumstances."*

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Boards face increasing pressure to launch special investigations, even when not strictly required to do so, Ms. Yates said, referencing the #MeToo movement as an example. Even so, there is a *"high bar"* for leading an investigation in the board, according to members. *"The boards I'm involved with are very cautious about elevating something to the board before it is clearly going to take that level of oversight, because in our experience, it is hard to dial back,"* one said. Some issues typically require board leadership—for example, fraud, executive misconduct, and serious cyber breaches. Ms. Yates advised members to consider *"public consciousness"* and potential impact on reputation, brand, and stakeholder confidence.

- **Consider all audiences and think with the end in mind.** Today's special investigations have multiple audiences, said Ms. Yates, *"Not just the obvious ones like regulators or law enforcement, but also shareholders, employees, and the public."* She advised boards to *"zoom out,"* balancing long-term and short-term risks. *"Think about how all the various pieces fit together and what will be in the best long-term interest of the company."* A member recommended taking a future perspective—projecting back from a point where *"everyone knows everything"*—to drive decision-making.
- **Take steps in advance.** Having a sound crisis-management framework in place can enable companies to respond to adverse events quickly and mitigate their impact.[2] Ms. Yates also recommended that companies strengthen their compliance programs. *"A lot of companies believe it doesn't matter, but developing a reputation within the business community for being a leader in compliance can buy you good will with regulators when issues arise."* This includes appropriate tone from the top and strong whistleblower processes.

Determining who within the board should lead the investigation

Once a board has decided to take on a special investigation, it must determine who will lead it. Members identified several options:

- **The audit committee.** Audit committees typically lead special investigations when allegations involve financial reporting, cybersecurity, or areas where the committee's specialized knowledge can accelerate and strengthen the investigation.
- **A special committee of the board.** In some cases, boards create special, ad hoc committees to oversee investigations, often based on members' experience and their ability to dedicate the significant amount of time required.
- **The full board.** The board may lead an investigation as a "committee of the whole," typically for strategic reasons. A member said, *"We made it a board matter, not just a committee matter. It was a high-profile situation, so the full board had an interest in it. No one wanted to defer to others to find out what was going on or to make decisions."*

Selecting external advisors

Some investigations can be conducted entirely with internal resources, such as the general counsel or internal audit, but others will require independent, outside expertise from lawyers, forensic accountants, or industry experts.

Ultimately, the need for outside experts is a judgement call. Determining the *"threshold when the board or audit committee should be doing an independent investigation and hiring their own counsel"* can be complicated, members said. Ms. Yates agreed: *"If there is any hint of the legal department's involvement in the issue, even if just from a negligence standpoint, or if there is a potential issue with the conduct of an executive to whom the general counsel reports, you do not want to involve the general counsel."* The board and audit committee should base its decision on what will best protect the integrity of the investigation.

Ms. Yates and members highlighted several benefits of keeping the general counsel and other internal leaders engaged, as long as there are no issues with their involvement. *"There is a lot of day-to-day management in terms of document reviews, interviews, and other learnings about the company. It can be easier for outside lawyers to work with the general counsel to get those answers, as long as they still pressure test on their own,"* Ms. Yates said. A member added that involving internal leaders, such as the CFO, can improve efficiency and enable the company to use the investigation to motivate important process enhancements.

Overseeing the investigation

Members discussed good practices in overseeing an investigation, including how to effectively work with outside counsel, communicate with key stakeholders, and disclose information to regulators and the public.

Working with outside counsel

When working with outside counsel, the committee must define the scope of the investigation—a challenging task since the breadth of an issue is often unknown. For example, the committee may wonder if the investigation should be limited to a single business unit or individual named in the allegation or expanded to the whole organization. Ms. Yates offered recommendations:

- **Define the charge and ask for an investigation plan.** Establishing scope upfront is an important step, Ms. Yates said, warning that *"one of the mistakes boards make is not defining what it is that the law firm is hired to investigate."* She suggested that committees both clearly define the charge and ask for an investigation plan at the beginning of the process. *"Recognize that they change as you progress,"* she said, *"but establish a plan so there is some accountability"* and a baseline for when key phases will happen, such as initial document gathering and employee interviews.

- **Set a cadence of regular updates.** Ongoing review and control are also critical: *"There should be a regular back and forth and status updates on what they are finding,"* Ms. Yates said. If the law firm presents a need to expand the scope, the committee should take the request seriously as long as *"it seems reasonable."*
- **Avoid presenting outside counsel with artificial deadlines.** Members noted that committees may feel pressure from stakeholders to move through an investigation quickly. One said, *"In each investigation I've been involved with, there has been a compelling business desire to have the legal team move quickly, because there is value in not having the investigation drag on."* Ms. Yates cautioned members to avoid pushing for speed at all costs. *"You have every right to expect efficiency from outside counsel, but efficiency and speed are not necessarily the same thing, and it can be problematic when you set artificial deadlines."* A thorough investigation should always be the priority.

Communicating with management, the board, and external auditors

Many constituencies must be considered during an investigation. Balancing the expectations of each of these can be challenging; thoughtful communication is essential to maintain trust and protect sensitive information. Ms. Yates and members discussed key considerations for communicating with stakeholder groups:

- **Management.** The audit committee needs to keep management informed during an investigation, but details should not be shared with members of management who may be implicated. As long as management does not compromise independence, the audit committee will typically communicate information such as investigation timing, general progress, employee resource needs, and potential impacts on financial reporting.
- **The board.** Members discussed sharing information with the rest of the board. *"The board dynamic is important. You want to come through the investigation with a board that is still collaborative, and you don't want to create pockets of distrust,"* one said. Proactively providing status updates can help to *"avoid sidebar conversations with individual directors,"* although the level of information provided should still be carefully managed. An EY article advises committees to share details with the board on a "need to know" basis to protect confidentiality.[3] Ms. Yates noted that having outside counsel describe the investigation process to the board can be helpful—*"then it's not as mysterious,"* she said.
- **External auditors.** External auditors also need to be kept informed, especially if the investigation relates to financial reporting or management's integrity, which could impact the auditors' ability to rely on management's representations. External auditors expect to be involved appropriately and provided with timely information. Early and transparent communication is ideal, builds trust between the committee and external auditors, and allows the auditors to provide input on the scope of the investigation. Ms. Yates advised

audit chairs to speak with outside counsel about external auditor communication. It is essential to *"make sure outside counsel isn't sitting on information when there may be an obligation to disclose that information to auditors."* Keeping auditors in the dark can create issues, as Ms. Yates explained: *"You don't need to add to your problems by having the outside auditor say, 'We're not signing.'"*

Disclosing to regulators, shareholders, and the general public

As an investigation unfolds, committees need to decide whether and when to disclose information to outside parties, including regulators, shareholders, and the public. Members described the complexity of gauging how these groups might interpret and react to disclosures.

- **Self-reporting to regulators.** If an investigation uncovers legitimate issues, committees must decide whether and when to self-report to regulators and which regulators to report to. Guidance from legal counsel is critical, and members were keenly interested to hear Ms. Yates' views on self-reporting to the DOJ. In a separate session, members discussed considerations for self-reporting to the US Securities and Exchange Commission (SEC) with guests Elad Roisman, former SEC commissioner and acting chair of the SEC, and Jennifer Leete, former associate director of the division of enforcement at the SEC. Both Mr. Roisman and Ms. Leete are now partners at the law firm Cravath, Swaine & Moore. The discussions addressed several issues related to self-reporting:
    - **Whether to self-report.** *"There is always the cost-benefit analysis. If it is an issue that you will have to disclose no matter what, that takes the question out of it and reporting earlier is almost always better,"* Ms. Yates said, *"The difficult question arises when you don't necessarily have to disclose because there isn't a regulatory requirement, but you might have exposure, so you want the benefit of voluntary disclosure."* Members agreed, underscoring the challenges in this *"gray area."* Ms. Yates emphasized that self-reporting is *"one of the most difficult decisions for a company to make,"* adding that, despite her 30 years at the DOJ, *"I will not say that you should self-report every time."* Nonetheless, regulators and law enforcement agencies are increasing the pressure to self-report and to do so earlier in the process.

      Members had mixed views on the benefits of self-reporting, with some expressing hesitation. *"The advice I've received from outside counsel is to not self-report. They say the risks are much greater than the rewards,"* one said. *"It feels like you never get enough credit when you self-report,"* said another. Ms. Yates, Ms. Leete, and Mr. Roisman emphasized that every situation is different and that significant analysis and judgment should go into each decision. Boards should think carefully about the long game and what a settlement could mean for the company down the road. Ms. Yates advised *"keeping your finger on what policies are announced and the pulse of resolutions to see how policies play out in real life. Use that to inform your decision."*

- **When to self-report.** Timing of self-reporting can also be murky. *"It isn't clear exactly when you are supposed to self-report,"* a member said. Many companies want to exercise caution and not report before the scope and scale of the issue are clear. Ms. Yates suggested taking the process in stages: inform the authorities about what you have found and what is unknown, then let them know that you will report updates as they are discovered. One member suggested establishing relationships with regulatory bodies before issues arise: *"Then when you go to them with something that is not fully baked, they are capable of having a good, rational response because you already have a relationship."* Members noted that this can be easier to do with the SEC and other regulators with whom companies have more interaction than they do with the DOJ.

  If a company holds off on self-reporting in order to more fully investigate an allegation but the SEC becomes aware of it via other channels, Ms. Leete pointed out that the company can *"pivot and cooperate. It's not a binary choice. You can still get substantial credit if you hold off on self-reporting and cooperate extensively."* In such cases, cooperation must be proactive and fulsome to meet the SEC's requirements, she said, explaining that it goes beyond basic compliance with requests and may include measures such as presenting internal findings to SEC staff, sharing documents and witness information, and making employees available for live testimony.

- **Which regulator to report to.** In many investigations, reports will need to be made to multiple agencies. Members described the challenge of knowing which agency to prioritize. *"The agencies don't always have perfectly aligned goals and policies,"* one observed. Ms. Yates offered guidance: *"The agency that has criminal authority is the one you want to make sure you talk to. You don't want to alienate any of the agencies, but make sure that these are satisfied first."* Companies should keep in mind the differences between the agencies. If they want to receive the benefits of the DOJ's voluntary disclosure program, they should report to the DOJ first, said Ms. Yates. Voluntarily disclosing to the SEC may show good faith, but it will not qualify for the DOJ's program.

  When reporting to different agencies at different stages of an investigation, Ms. Yates cautioned members to be consistent. If there have been changes, *"document and address what those changes have been."* When it comes to resolutions, she also noted that there is a *"no piling-on aspect that should be invoked"* so that companies do not have to pay multiple agencies significant fines for the same misconduct.

- **How to navigate law enforcement requests.** In some cases, reports also need to be made to a security or intelligence agency, like the FBI, who may ask companies to keep information quiet during confidential investigations, such as a major cybersecurity incident. Members wondered how to handle such requests. *"If a national security agency is asking you not to disclose, you are fairly safe to follow their request,*

especially if it is for a relatively short period of time," Ms. Yates advised. *"The DOJ has a national security function, so there is a good chance the DOJ is aware of the issue."*

- **Disclosures to shareholders and the general public.** Deciding how and when to disclose an investigation and its findings to shareholders and the public is complex. Announcements can trigger harm, such as a fall in stock price. The committee risks sharing erroneous information that would later need to be corrected, undermining the investigation's credibility. A comprehensive communications plan is key to determining when public announcements should be made and the level of information to include. One member observed that *"the art is to inform and not inflame—that is the tension the committee wrestles with."*

Navigating the current enforcement environment

Members were keen to discuss the current enforcement priorities of regulators like the DOJ and SEC. Ms. Yates, Mr. Roisman, and Ms. Leete provided their perspectives and shared key considerations for audit chairs to keep in mind.

DOJ enforcement priorities

In September 2022, Deputy Attorney General Lisa Monaco announced updates[4] to the DOJ's approach to investigating and prosecuting corporate crime, signaling a tougher enforcement environment. The new guidelines emphasize the need for early and voluntary self-reporting by companies, prioritize disclosure of evidence relevant to individual accountability, and encourage companies to strengthen compliance programs.

Ms. Yates noted that the DOJ is seeking to clarify the benefits of voluntary disclosure. *"You will never get a guarantee, but you will get something more concrete now."* She noted that the DOJ is now looking at a company's long-term record and ethos. *"For example, say you had a tax fraud issue in the past and now you have a Foreign Corrupt Practices Act violation. The DOJ has made it clear that they will now look at if you've been involved in wrongdoing in the past; even if it is not the same lane of wrongdoing, they'll still take it into account."*

SEC enforcement priorities

The SEC is pursuing a robust and unprecedented rulemaking agenda, but Ms. Leete, who recently departed the commission after more than 20 years in the enforcement division, noted that enforcement, while aggressive, is still *"ultimately tethered to the courts and what they can win in a litigation."* The following SEC enforcement priorities have been highlighted in recent testimony by Gurbir Grewal, director of the SEC's Division of Enforcement:[5]

- **Robust enforcement.** The enforcement division is pursuing cases with a sense of urgency and investigating risks for investors, such as crypto, cybersecurity, and environmental, social, and governance matters. Stronger enforcement also applies to gatekeepers, including attorneys and auditors.
- **Robust remedies.** The SEC is seeking tougher penalties for corporate recidivists, and forward-looking relief such as officer and director bars. At the meeting, Ms. Leete highlighted the SEC's focus on deterrence and its publicly articulated view that past penalties have not been high enough to deter big companies. *"That is animating big penalty numbers now,"* she said.
- **Robust compliance.** Mr. Grewal has underscored the need for public companies to "think rigorously about how their specific business models and products interact with both emerging risks and their obligations under federal securities laws, and tailor their internal controls and compliance practices and policies accordingly … They cannot rely on check-the-box compliance policies."[6]

Concluding the investigation

Members explored important factors to consider when concluding investigations, including when to stop, remediation efforts, and ongoing interactions with regulators.

When to end an investigation

Because committees overseeing investigations face heavy scrutiny, they feel pressure to do a thorough job. At the same time, however, they want to avoid being excessive. Knowing when an issue has been fully investigated can be tricky.

Ms. Yates described how outside counsel may sometimes have a different view than the committee. Lawyers may want to follow *"every rabbit trail"* to avoid risk *"and to feel good that we have done everything,"* but that is not always the best approach. *"Pick and choose what really matters and what doesn't,"* she advised. Defining boundaries is key to preventing investigations from running on too long, she said, referring to the investigation plan and scope discussions from earlier in the meeting.

One member described how outside counsel had helped in thinking through when to conclude an investigation, noting, *"If you pick the right outside counsel, the decision of when to end isn't a compromise but a product of joint conversation."* But other complications can arise, as an audit chair explained: *"We had all the regulators signed off and there was no issue, but there were the people internally who had raised the issue to begin with; they weren't satisfied. Notwithstanding regulators and a lot of money, it came down to employees who just didn't agree with regulatory standards. It gets very complicated."*

What to do after an investigation ends

Once an investigation is completed, audit committees often have tasks that require their time and attention. Members and Ms. Yates discussed good practices for this final stage.

- **Develop remediation plans.** The audit committee and investigation team will likely need to create a remediation plan and provide continuing oversight of its implementation. Several recommendations were shared:
  - **Make improvements as you go.** Implementing remediation plans is vital in the post-investigation phase, but one member suggested that committees should make changes while the investigation is in progress: *"If you unearth control weaknesses, don't wait until the investigation ends to make changes. Implement them immediately."*
  - **Apply learnings across the company.** Investigations may focus on a specific function within the company, but members recommended applying findings across the whole firm. *"I found it useful to take the learnings from the investigation and build it into the compliance training done across the country and worldwide,"* one said.
  - **Ensure that *"root cause"* cultural issues are addressed.** Investigations often uncover deeper corporate culture issues that were part of an underlying problem. Companies may be tempted to focus on the *"black-and-white issues, like criminal violations, instead of broader cultural issues,"* Ms. Yates observed, but getting to the root cause is vital. One member shared an example: *"After a special investigation, they did a root-cause analysis and focused on tone from the top and middle. There was wonderful cultural change that came to the company as a result of it."* Another described an investigation where the committee requested that management perform a culture survey to enable the committee to monitor and assess changes.
- **Be prepared for ongoing interactions with regulators.** Interactions with regulators may continue after an investigation concludes. Regulators may initiate or continue their own investigations, and the committee will need to maintain communication with them. In other cases, regulators may rely on the committee's findings, as one member described: *"The investigation was led internally. We presented our findings to the SEC, who reserved the right to do their own investigation pending our work, but they chose not to and used ours."*
- **Avoid investigation fatigue.** Lengthy investigations can create *"organizational exhaustion,"* one member cautioned, *"and people may forget to pause and ask what we learned from this."* Ms. Yates agreed and noted that it can be particularly challenging when the issue at hand was not a crime but came close to it. *"Fatigue may kick in,"* and the necessary changes may not be made; however, if a similar issue arises in the future, regulators will notice that preventative measures were not implemented. It is part of the *"look-forward mentality,"* Ms. Yates said, advising organizations to *"think about what could happen in the future if the issue came up again."*

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.

Appendix 1: Guest biography

Sally Yates is a partner in King & Spalding's Special Matters & Government Investigations practice and leads the firm's Crisis Management practice. Her practice focuses on counseling clients in complex and sensitive matters, including government enforcement and regulatory matters, congressional investigations, compliance, corporate governance, and crisis management. Drawing upon her nearly three decades at the Department of Justice, she specializes in internal and independent investigations for public and private organizations and boards.

As the second-highest ranking official at the US Department of Justice (DOJ) and as Acting Attorney General, Ms. Yates was responsible for all of DOJ's 113,000 employees including all prosecutorial, litigating, and national security components.

Prior to becoming Deputy Attorney General, Ms. Yates was the first woman to serve as US Attorney for the Northern District of Georgia. During her five years as the chief federal law enforcement official for the district, she oversaw the prosecution of all federal crimes and the litigation of civil matters and immediately became a leader in the Department as Vice Chair of the Attorney General's Advisory Committee, which guides DOJ's strategies and policy decisions.

She has tried numerous white collar and public corruption cases, and she was the lead prosecutor of Olympic bomber Eric Rudolph.

Before entering government service, Ms. Yates practiced as a civil litigation associate at King & Spalding. She has served as a Visiting Distinguished Lecturer at Georgetown University Law Center, currently co-chairs the Board of Trustees of the non-partisan Council on Criminal Justice and is a member of the Board of Directors of the Ethics Research Center. Ms. Yates is a frequent speaker on a variety of public policy issues.

Appendix 2: Participants

The following ALCN members participated in all or part of the meeting:

- Judy Bruner, Applied Materials and Seagate Technology
- Jeff Campbell, Aon
- Janet Clark, Texas Instruments
- Bill Easter, Delta Air Lines
- Gretchen Haggerty, Johnson Controls
- Bob Herz, Fannie Mae and Morgan Stanley
- David Herzog, MetLife
- Akhil Johri, Boeing and Cardinal Health
- Arjun Murti, ConocoPhillips
- Leslie Seidman, GE
- Greg Smith, Intel
- Cindy Taylor, AT&T
- John Veihmeyer, Ford
- David Weinberg, The Coca-Cola Company

The following ACLN members participated virtually in part of the meeting:

- Pam Craig, Merck
- Dave Dillon, 3M and Union Pacific
- Bella Goren, Marriott
- Charles Holley, Amgen and Carrier Global
- Suzanne Nora Johnson, Pfizer
- Fred Terrell, Bank of New York Mellon
- Tracey Travis, Meta
- Jim Turley, Citigroup

The following European Audit Committee Leadership Network (EACLN) members participated virtually in part of the meeting:

- Aldo Cardoso, Imerys
- Carolyn Dittmeier, Assicurazioni Generali
- Liz Hewitt, National Grid
- David Meline, ABB
- Karyn Ovelmen, ArcelorMittal
- Maria van der Hoeven, TotalEnergies

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

- Julie Boland, EY US Chair and Managing Partner and Americas Managing Partner
- John King, EY Americas Vice Chair—Assurance
- Patrick Niemann, EY Americas Leader, EY Audit Committee Forum

Appendix 3: Reflection questions for audit committees

- ? What experience have you had with special investigations? What gave rise to the investigation and what triggered board involvement?
- ? How have your boards determined who oversees a special investigation? When might the audit committee take the lead versus a special committee?
- ? How does your audit committee/board prepare for significant investigations? What escalation policies and/or internal communication protocols have you found most useful?
- ? What factors led to a decision to engage external counsel, and what criteria did you consider during the selection process?
- ? What kinds of challenges have you encountered in overseeing investigations? What might you do differently in the future?
- ? At what point during an investigation would you consider self-reporting to a regulator or law enforcement agency? How have your views on self-reporting changed in recent years?
- ? At what point during an investigation would you consider disclosures to shareholders and the broader public? What factors should be considered?
- ? How do you know when an investigation should be concluded? How can you be sure it is comprehensive but not excessive?
- ? What good practices have you observed for remediation plans following a completed investigation?

Endnotes

[1] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

[2] Ramesh Moosa, "What Boards Must Watch for in Corporate Investigations," EY, October 20, 2021.

[3] Moosa, "What Boards Must Watch for in Corporate Investigations."

[4] U.S. Department of Justice, "Further Revisions to Corporate Criminal Enforcement Policies Following Discussions with Corporate Crime Advisory Group," memorandum, September 15, 2022.

[5] Gurbir S. Grewal, "Testimony on 'Oversight of the SEC's Division of Enforcement' Before the United States House of Representatives Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets" (speech, US House of Representatives: Washington DC, July 21, 2022).

[6] Grewal, "Testimony on 'Oversight of the SEC's Division of Enforcement' Before the United States House of Representatives Committee on Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets."