



Best Practices for Conducting Board-Managed Investigations

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Presentation Overview

- I. SEC Investigations Involving Companies
 - Seaboard Report Factors (Self-Policing, Self-Reporting, Remediation, and Cooperation)
- II. Analysis of Four Factors Identified in the Seaboard Report
- III. The Benefits of Independent Investigations
- IV. When To Conduct an Independent Investigation
- V. The Mechanics of an Independent Investigation
- VI. Importance of Remediation
- VII. Concluding Remarks

The Government's Position

- “My number one commitment to the American people is that we will continue to devote significant resources to combating financial fraud and be as aggressive and creative as we can be in holding accountable those who, in violating the law, contributed to the financial crisis.”

- Attorney General Eric Holder, January 27, 2012

- In the area of financial crisis-related cases, we filed charges against nearly 100 individuals and entities ... It should come as no surprise that there are more actions to come.”

- SEC Chairman Mary Shapiro, February 24, 2012

Post-Madoff Era

- Aggressive enforcement posture of DOJ and SEC
- Enhanced whistleblower bounties and non-retaliation protections
- Negligence-based theories/collective scienter
- Increased congressional scrutiny
- U.S. District Court questions SEC settlements
- Plaintiffs' cases against independent directors

Financial and Reputational Impact of Misconduct

- Siemens reportedly spent over \$1 billion on its investigation into bribes to government officials.
- Avon reportedly has spent in excess of \$150 million on its ongoing FCPA investigation.
- St. Joe's stock dropped 7.7 percent after the announcement of an SEC investigation.
- Wal-Mart's stock dropped 4.7 percent after *The New York Times* reported allegations of vast bribery in its Mexico operation.

Internal vs. Independent Investigations

Internal Investigation

- Directed by management, either with company investigative resources or outside counsel and consultants

Independent Investigation

- Directed by a committee of the Board of Directors (e.g., audit committee or special committee) with independent counsel and consultants

SEC Investigations Involving Companies: The Seaboard Report

- In October 2001, the SEC released a policy statement concerning the factors the Commission would evaluate in determine whether to bring an enforcement action against a company and how it would credit a company's cooperation.
- The report is commonly referred to as the "Seaboard Report." In the Matter of Gisela de Leon-Meredith (Release No. 44969, October 23, 2001). The Seaboard Report remains the operative document for how the Commission evaluates charging a company, as reiterated recently in the SEC's Enforcement Manual (p.100).
- In Seaboard, the Commission indicated it would evaluate four factors in assessing whether and how to charge a company:

Self-Policing

Self-Reporting

Remediation

Cooperation

SEC Investigations Involving Companies: The Seaboard Report

- The Seaboard Report <https://www.sec.gov/litigation/investreport/34-44969.htm> provides thirteen areas of inquiry that the SEC uses as “criteria [it] will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation, and cooperation from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.”

Seaboard Factor 1: Self-Policing

- “How did the misconduct arise?”
- “Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company?”
- “What compliance procedures were in place to prevent the misconduct now uncovered?”
- “Why did those procedures fail to stop or inhibit the wrongful conduct?”

Seaboard Factor 1: Self-Policing

- “How high up in the chain of command was knowledge of, or participation in, the misconduct?”
- “Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct?”
- “How systemic was the behavior?”
 - Bad Actor, Bad Bunch, Bad Crop...ABC’s of Fraud
- “Is it symptomatic of the way the entity does business, or was it isolated?”
 - The SEC staff will focus on emails and communications from senior management to investigate the “tone at (from) the top.”

Seaboard Factor 2: Self-Reporting

- “Did the company promptly, completely, and effectively disclose the existence of the misconduct to the public, to regulators, and to self-regulators?”
- “Did the company cooperate completely with appropriate regulatory and law enforcement bodies?”

Seaboard Factor 3: Remediation

- “What steps did the company take upon learning of the misconduct?”
 - Engaged counsel and forensic auditors to investigate?
- “Are persons responsible for any misconduct still with the company? If so, are they still in the same positions?”
- “Did the company identify what additional related misconduct is likely to have occurred?”

Today's best practice and expectation is to conduct a root cause analysis to ensure the company is not remediating the symptoms, but the actual cause(s). Recidivistic behavior is not a label you want placed on your company!

Seaboard Factor 4: Cooperation

- “What processes did the company follow to resolve many of these issues and ferret out necessary information?”
- “Were the Audit Committee and the Board of Directors fully informed? If so, when?”
- “Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins, and consequences of the conduct and related behavior?”
- “Did management, the Board, or committees consisting solely of outside directors oversee the review?”

Seaboard Factor 4: Cooperation

- “Did company employees or outside persons perform the review?”
- “If outside persons, had they done other work for the company?”
- Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?”

Benefit of Cooperation and Remediation

- BizJet: Will pay a fine of nearly \$12M for bribing government officials in Mexico and Panama to secure maintenance contracts. Besides self-disclosing the FCPA violations, BizJet:
 - Gave “extraordinary cooperation, including conducting an extensive internal investigation, voluntarily making U.S. and foreign employees available for interviews, and collecting, analyzing, and organizing voluminous evidence and information for the department.”
 - “Engaged in extensive remediation, including terminating the officers and employees responsible for the corrupt payments, enhancing their due-diligence protocol for third-party agents and consultants, and heightening review of proposals and other transactional documents for all BizJet contracts.”

Audit Committee Guidance

- The Sarbanes-Oxley Act of 2002 established certain requirements for audit committees, including:
 - Procedures for receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters
 - Procedures regarding the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters
 - Authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties
 - Funding to engage advisors as it deems appropriate

Audit Committee Oversight of an Internal Investigation

- Notwithstanding the corporate waste doctrine, independent directors rarely will face criticism for doing too much.
- They could expose themselves and their company to liability for doing too little.
- An appropriately managed independent investigation will yield tangible benefits.
- Although independent investigations should not pit the audit committee against management, the interests of the audit committee and management are not necessarily aligned.
- Investigation may find issues with compliance, supervision, internal audit, and other management functions.

Culpability Score

- Senior executives within the organization participated in, condoned, or [were] willfully ignorant of the offense;
- [T]olerance of the offense by substantial authority personnel was pervasive throughout the organization;
- There was prior history of a similar offense in the company's past; and/or
- The organization obstructed justice by impeding the investigation or prosecution.

Mitigating Factors

- If the subject organization had in place at the time of the offense an effective compliance and ethics program;
- If the organization promptly reported the offense to appropriate government authorities once they became aware of its existence;
- If the organization fully cooperated in the investigation; and
- If the organization clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct.

Notable SEC Settlements

Importance of Independent Investigation

Bell Microproducts, Inc. (February 2010)

- Special committees of the Board retained independent counsel to investigate stock-based compensation and reserve/accrual issues.
- Independent counsel to the Board, accompanied by company counsel, self-reported to the SEC its findings of accounting inaccuracies that resulted from a material weakness in internal controls over financial reporting, before the SEC initiated its investigation.
- Independent counsel reported findings of its investigations to the SEC; the Staff did *not* recommend enforcement action.

Notable SEC Settlements

In the Matter of infoUSA Inc. (March 2010)

- Settlement: Cease and desist; no financial penalty to the company
- The Board's Special Litigation Committee retained independent counsel to investigate the CEO's perquisites and related party transactions.
- The SEC stressed that the internal investigation reduced the staff's time and resources in concluding its own investigation.

Notable SEC Settlements

In the Matter of Navistar International Corp. (Aug 2010)

- Settlement: Cease and desist; no financial penalty to the company
- Audit committee engaged independent counsel to investigate various accounting issues.
- Independent counsel provided regular updates of its investigation to the SEC.
- The SEC highlighted Navistar’s “decision to conduct an independent investigation” among the cooperation efforts and remedial actions that allowed the company to avoid a civil penalty.

When to Conduct an Independent Investigation

Questions to Ask:

1. Whether the alleged misconduct was confined to lower-levels of the organization and involved non- managerial personnel, or whether management was involved in the conduct, knew about it, or should have known about it?
2. Whether the misconduct was motivated purely by self-interests or whether the misconduct resulted in financial benefits to the company?
3. Whether the conduct may result in a restatement or otherwise be material under federal securities laws?

When to Conduct an Independent Investigation

Questions to Ask:

4. Whether compliance or internal audit identified and caught the misconduct?
5. Whether the misconduct resulted in a material misstatement or omissions in corporate filings?
6. Whether the misconduct will result in significant regulatory sanctions (e.g., FCPA)?

Mechanics of an Independent Investigation

- Selection of independent counsel and retained by audit committee
- Selection of forensic accounting firm/retained by audit committee and reporting to independent counsel
- Decide appropriate scope early and evaluate throughout
- Preserving and gathering information
- Interviews of employees

Mechanics of an Independent Investigation

- No sharing of investigation findings with management, but can keep apprised of the process
- Interaction in the process with management, legal, and internal audit
- Interaction in the process with outside auditors
- Periodic reports to audit committee or special committee of the Board of Directors
- In most cases, reporting findings to regulators

Independent Counsel Interaction with Internal Audit and In-House Counsel

- Independent counsel can utilize internal audit and in-house counsel as a resource but must not rely on them.
- Documents must be collected by independent counsel.
- Independent counsel must verify information obtained by internal audit.
- Company personnel (e.g., internal audit and in-house counsel) must not be present for interviews.

Selecting Independent Counsel

- Counsel should be retained by the audit committee or special committee.
- May be retained to represent the company at the behest and sole direction of the audit committee or special committee.
- Outside counsel should have experience with internal investigations *and* good reputation with regulators.
- Outside counsel should not have previously represented the company; disclosure counsel cannot serve as independent counsel.

Dodd-Frank Whistleblower Bounty

- Congress encourages individuals to report any suspected violation of the federal securities laws *directly to the SEC* (or commodities violations to the CFTC) by offering individuals between 10–30 percent of any recovery, where the SEC recovers over \$1 million.
- Another step in the government’s continuing attempts to encourage cooperation.
 - SEC and DOJ “cooperation credit”
 - SEC cooperation initiatives (NPAs/DPAs)

Impact of Dodd-Frank Whistleblower Provision Rules

- Increased time pressure to evaluate and investigate potential wrongdoing
- Increased threat of more and quicker derivative and shareholder class actions
- Increased threat of employment-related suits by alleged whistleblowers
- Increased importance of tailored compliance programs and prompt investigative responses

New Wrinkle for Whistleblowers – Hollow Victory for Companies

- > On February 21, 2018, Justice Ruth Bader Ginsburg delivered the unanimous opinion of the Court, which held the anti-retaliation provisions of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act *do not extend to employees who have reported internally but extend only to employees who have reported suspected securities law violations to the Securities and Exchange Commission*, which reversed the 9th Circuit decision.
- > Prior to the Supreme Court’s decision, the 5th Circuit held that employees must provide information to the SEC while the 9th and 2nd Circuits held that *reporting internally* is enough for employees to qualify for Dodd-Frank Act’s anti-retaliation protections.
- > Bottom line - to qualify as a “whistleblower” under Dodd-Frank, individuals now have a clear incentive to report all sorts of observations to the SEC before reporting those observations through their company’s internal reporting infrastructure. While “approximately 80 percent of the whistleblowers who received awards in 2016 reported internally before reporting to the Commission,” that trend is likely to be reversed.
- > Moreover, even if a purported whistleblower is not protected by Dodd-Frank, he or she may still be protected by Sarbanes-Oxley’s anti-retaliation provisions or relevant state laws. As the Supreme Court made clear in its decision, Dodd-Frank and SOX work together to protect whistleblowers whether they are dual reporters or purely internal reporters.

Preparing Today for Tomorrow's Whistleblower Complaint

- What can a company do to encourage internal reporting of potential violations of the federal securities laws?
- Is your allegation review or triage process documented and followed consistently?
- How should a company respond to an internal whistleblower?
- How should a company respond to an SEC investigation premised on a whistleblower complaint?
- How should a company treat a whistleblower?

The Importance of Remediation

- Dismissing or appropriately disciplining wrongdoers in a timely manner – *Recent FCPA case involving Panasonic Avionics, DOJ noted its concern in the **DELAY** in **TERMINATING** Panasonic Avionics president and other executives.*
- Replacing wrongdoers with appropriately-skilled personnel
- Modifying and improving internal controls and procedures to prevent recurrence of the misconduct
 - root cause analysis
- Enhancing the organization's ethics and compliance program
- Increasing training and communication to educate employees
- Appropriately compensating those adversely affected

Federal Sentencing Guidelines for an Effective Ethics and Compliance Program

Seven Steps:

1. Standards and Procedures
2. Organizational Leadership
3. Exclusion of Prohibited Persons
4. Training and Communication
5. Monitoring, Auditing, and Evaluating Program Effectiveness
6. Performance Incentives and Disciplinary Actions
7. Remedial Action

Amendments/Conditions for Sentencing Credit

- > Individual(s) with operational responsibility for the compliance and ethics program have direct reporting obligations to the governing authority or an appropriate subgroup (e.g., an audit committee of the board of directors);
- > Compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely;
- > Organization promptly reported the offense to appropriate governmental authorities; and
- > No individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.

Board-Led or Company-Managed Internal Investigations—5 Scenarios

1. An employee leaves the company and takes a thumb drive containing proprietary data on the company's new products.
2. \$10,000 is missing from petty cash in the Russian subsidiary of a company.
3. A sexual harassment allegation has been made against the company's CEO.
4. There are reports that managers in the company's Chinese subsidiary are giving Rolex watches as holiday gifts to Chinese government officials.
5. A hotline caller reports accounting misconduct by several country managers in the company's LATAM subsidiaries.

Best Practices for Internal Investigations

1. Take action quickly. The investigation can have an impact on financials, and there is a need to preserve evidence.
2. Determine whether to use an internal or external investigative team.
3. Obtain counsel that has experience with investigations and credibility with regulators.
4. Decide if the investigation team will report to the audit committee or a special committee.
5. Consider designating a liaison on the audit committee to manage day-to-day interactions with the investigation.

Best Practices for Internal Investigations

6. Obtain the concurrence of auditors, regulators, and other relevant parties.
7. Keep notified of the progress of the investigation.
8. Consider impact of the attorney-client privilege on the interactions with regulators.
9. Use the proper advisors and resources to assist the investigation team.
10. Keep management informed of the process, and consider the disruptive impact the investigation has on them.

Best Practices for Internal Investigations

11. Exclude company personnel from investigatory interviews.
12. Do not have the investigation team share documents with individuals.
13. Meet preservation requirements for documents, and have investigation team responsible for collection.
14. Manage internal and external communications. Encourage employees to cooperate with the investigation, and designate a spokesman to handle external questions.

Concluding Remarks

- The DOJ and SEC value and reward *independent investigations*.
- An investigation conducted by disclosure counsel or at the direction of the GC or management is *per se* not independent.
- The DOJ and SEC have expressed concerns with investigations that are not independent. The DOJ and SEC will conduct their own detailed investigation if there are concerns with independence.
- The DOJ and SEC are becoming more focused on senior management in recent years, prompting the need for an independent investigation.
- An investigation that is efficient, focused, and cost-effective is important.



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Education

Bloomsburg University
Bachelor of Science in
Business
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Jonathan T. Marks, is a partner in Baker Tilly's Forensic and Litigation practice. He has more than 30 years of experience working closely with his clients, their board, senior management, and law firms on global (cross-border) fraud and misconduct investigations, including global bribery, corruption, and compliance matters. Jonathan assists his clients in mitigating future potential issues by conducting root-cause analysis, developing remedial procedures, and designing or enhancing governance, global risk management, and compliance systems along with internal controls and policies and procedures. He is a well regarded author and speaker who has gained international recognition for developing the Fraud Pentagon™ and other thought leadership that has enhanced the profession.

Jonathan has conducted investigations, internal audits, governance reviews, global fraud risk assessments, built/enhanced compliance and third party risk management programs, drafted policies and procedures, and developed customized training for some of the world's largest companies.

Before joining Baker Tilly, Marks held leadership positions at a national accounting firm and a global disputes and investigations firm.

Jonathan T. Marks (continued)

CPA, CFF, CITP, CGMA, CFE

Selected Experiences

- > Led a 10A Investigation that involved several complex issues, including alleged illegal acts related to the valuation of inventory, inventory reserves, and the overall completeness and accuracy of the books and records. Jonathan worked closely with outside counsel and the external auditor, including their national practice and forensic group.
- > Developed a road map, synthesized massive amounts of data with more than fifteen organizations, and prepared an analysis to assist counsel in the defense of an alleged stock manipulator. Jonathan met with and presented the analysis to the US Attorney, FBI, SEC, and FINRA, who accepted and commented on quality and thoroughness of the work product.
- > Provided forensic accounting support to counsel for two senior executives (CEO and CFO) that were subjects of an SEC investigation.
- > Managed a special audit committee investigation for a Forbes Top 100 company that spanned many countries and involved performing root cause analysis related to alleged \$400 million fraud related to channel stuffing by a large pharmaceutical concern. The investigation uncovered deficiencies in the overall governance framework, and legal, compliance, and internal audit functions. Subsequent to the investigation, Jonathan was retained to assist with the remediation of the compliance and internal audit functions. He also led a team to enhance evaluate the design and when necessary enhance internal controls. He personally assisted in hiring of the internal audit - forensic accounting lead in the United States.
- > Engaged by the audit committee of a Fortune 50 company to perform a root cause analysis and provide an assessment to the full board on the results of a massive internal investigation related to alleged revenue recognition issues. The initial investigation was conducted by a highly-reputable law firm who was assisted by a Big 4 accounting firm. Jonathan assisted in drafting the report, which provided recommendations on improving governance, risk, compliance, and internal controls.
- > Retained by outside counsel to investigate allegations from a whistleblower the general counsel and the controller were engaged in several schemes to defraud a large hospital group. The investigation uncovered many internal controls deficiencies, including weaknesses in the risk assessment process and internal audit plan.
- > Worked directly with the US Attorney, FBI, IRS CID, and US Customs on a massive investigation involving a myriad of fraud schemes, concealment strategies, and conversion tactics that involved individuals, private, and publicly held companies. I received the Chairman's Award of Excellence for my work and commitment.

Industry Involvement

- > American Institute of Certified Public Accountants,
- > American Bar Association,
- > Association of Certified Fraud Examiners
- > Institute for Fraud Prevention
- > FEI Research Committee



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Principal

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Education

University of Notre Dame
BA in Finance and Business Economics

Anne has significant experience providing litigation support and investigative services for trial lawyers, in-house counsel, and trustees throughout the dispute process. She has advised clients and counsel in expert witness assignments related to bankruptcy, construction claims, fraud allegations, lost profit, and damage issues, post-merger and acquisition disputes and shareholder disputes. Anne's industry experience includes automotive, banking, biotechnology/pharmaceutical, education, energy, financial services, food and beverage, gaming, insurance, manufacturing and distribution, oil and gas, real estate/construction, and retail.

Anne has led teams in performing complex financial analyses and asset tracing assignments. She has performed forensic investigations relating to embezzlement, financial statement fraud, and business fraud in merger and acquisition transactions. She has performed complex analyses of costs associated with breaches of contracts, analyses of increased construction costs and project cost growth, and lost profits calculations. Additionally, she has led teams in performing analyses relating to insolvency, fraudulent conveyance, and preferences.

She has led teams in the preparation of expert reports reflecting professional opinions, assisted counsel with the discovery process, developed strategy, and prepared witnesses for deposition and trial testimony. She has advised clients and counsel in dispute resolution forums, including settlement negotiations, arbitrations, mediations, and federal, state and bankruptcy courts. Anne has provided trial testimony in federal court.

Before joining Baker Tilly, Anne was a managing director at Mesirow Financial.

Anne Rasho Vanderkamp (continued)

CFE

Selected Experiences

- > Served as the Financial Advisor to the Governance Committee of the Board of Directors of Caesars Entertainment Operating Company, Inc. (CEOC), in the CEOC bankruptcy. Retained to advise the Governance Committee regarding potential causes of action between or among CEOC, its direct and indirect shareholders, subsidiaries and affiliates. Analyzed transactions between CEOC and affiliated entities, asset dispositions and closures, financing transactions, and intercompany agreements and transfers. Analyzed the exchange of value and activities undertaken by the directors and officers in connection with planning and negotiating the transactions and addressing related strategic objectives.
- > Retained to provide expert witness testimony regarding lost profits on behalf of cosmetics retailer in litigation with a supplier.
- > Served as the Financial Advisor to the Disinterested Directors of the Board of Directors of Seadrill Limited (Seadrill) in the Seadrill bankruptcy. Retained to investigate and analyze certain transactions and relationships between SDRL and/or its subsidiaries and certain related persons. Assessed the financial condition of SDRL as a consolidated entity and the exchange of value in certain related party transactions, and analyzed certain other ventures and transactions between SDRL and related parties.
- > Retained as the Financial Advisor to the Examiner of Residential Capital, LLC (ResCap), a leading real estate finance company, during ResCap's Chapter 11 restructuring. Conducted an investigation as to the potential causes of action and activities of the officers and directors of ResCap and its parent, Ally Financial Inc., and Cerberus Management and their affiliates, in connection with pre-petition and post-petition transactions, agreements, transfers, loans, claims, releases, settlements, and the relationships among the involved parties. Wrote various sections of the Examiner's 2,200 page report, and led teams in performing underlying financial analyses.
- > Engaged by counsel to Tronox Inc., a multinational manufacturer and marketer of specialty chemicals, and the Anadarko Litigation Trust. Analyzed fraudulent conveyance claims related to the debtors' spin-off from Kerr-McGee Corp, an oil and gas exploration and production company. Prepared expert reports and assisted in the preparation of deposition and trial testimony regarding reasonably equivalent value and damages.
- > Retained by counsel on behalf of the Liquidating Trustee of Sentinel Management Group (Sentinel), a futures commission merchant. Led teams in the preparation of expert reports regarding Sentinel's financial condition and the circumstances, which led to its collapse. Assisted in the preparation of deposition and trial testimony in connection with litigation matters against a bank, an auditing firm and certain customers/counterparties. Provided trial testimony in the criminal case against Sentinel's former CEO.

Industry Involvement

- > Daily DAC, editor-in-chief
- > Association of Certified Fraud Examiners, member
- > International Women's Insolvency & Restructuring Confederation, Chicago network, chair 2015 - 2016
- > American Bankruptcy Institute, member

For More Information



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