



Independent Examiners and Internal Investigations

By Bill Lenhart and Jack Williams

These are challenging times for corporations and their boards. Government, media, and private watchdog organizations are closely scrutinizing almost every decision made or practice undertaken by a corporation. Allegations of corporate wrongdoing often invite regulatory attention by the SEC, Federal Trade Commission, and Department of Justice, among others. As W. Schuman and J. Sanders noted in the June 2006 issue of *Director's Monthly*:

“Time and again, corporations under scrutiny have been treated more favorably, and have received acceptable resolutions, by appointing special committees to conduct internal investigations of their own activities...”

Schuman and Sanders speak to the use of special committees to conduct internal investigations; their observations hold true for the use of an independent examiner.

Emerging Use of Independent Examiners

Although the use of examiners has been around for many years in the bankruptcy forum, in recent years a similar role and process has increasingly been pursued in SEC investigations. All indications suggest that other governmental agencies may also seek to develop the role of the independent examiner as jurisdictions expand and agency resources are stretched.

In most instances, independent examiners are brought in as part of a settlement agreement to complete an investigation begun by the SEC. Generally, the negotiated agreement provides that the corporation's board of directors must choose an independent examiner, normally an accountant or attorney, subject to SEC approval. The independent examiner must be free of any conflicts of interest with the company, competent, and beyond reproach.

Procedures for Retaining an Independent Examiner

This timing factor distinguishes the use of an independent examiner from a special committee. The use of an independent examiner is a board tool employed *after* problems have been identified by a governmental agency such as the SEC.

The selection of the independent examiner follows what is now a familiar pattern. Generally, after the SEC commences its investigation and detects a potential problem, the SEC directs the target corporation to retain an independent examiner subject to approval by the SEC. The costs associated with retention of the independent examiner are borne by the corporation. After appointment, the independent examiner completes the investigation consistent with the negotiated settlement agreement between the corporation and the SEC. Depending on the examiner's mandate, the investigation may include informal interviews, a review of documents, and possibly a forensic review of computer hard drives, PDAs, and other electronic devices.

Presently, the independent examiner does not have subpoena power; thus, the examiner must rely on the cooperation of the corporation, its employees, former employees, and third parties. However, a well-drafted settlement agreement will require corporate cooperation. The last thing the board should do in this situation is fail to cooperate with the independent examiner.

Finally, the independent examiner should report his findings. Throughout the investiga-

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Director Summary: When corporations under regulatory scrutiny are directed to appoint an independent examiner, it behooves the corporation to select wisely and cooperate fully with the investigation. Whether the examiner is an attorney or accountant, the appointee should be conflict free, competent, and experienced. The end result should be reinforced public trust in the company.



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tory and the report drafting processes, the independent examiner should be in regular contact with the board and corporate counsel and the SEC.

Board Considerations in Selecting an Independent Examiner

A board's decision in selecting an independent examiner is a critical one. It may have far-reaching implications as the corporation continues forward in its operations. Initially, the board must select an individual free of any actual or perceived conflict of interest. Moreover, the board must ensure independence of the examiner. Thus, once the investigation is commenced, contact between the corporation and the examiner (and his/her staff) must be formal and documented. Any credible question of corporate control will compromise the investigation, causing the SEC and the public to lose confidence in the investigation.

Furthermore, any independent examiner must have the resources to conduct the investigation in a timely, thorough, and exhaustive fashion. Additionally, a board must ensure that any examiner selected is competent and experienced. These situations are simply too crucial to the corporation to select an examiner that needs significant on the job training.

This particular attribute requires us to confront an often asked question: should we choose a lawyer or an accountant? Essentially, the resolution of the question turns largely on precisely what is being investigated. For example, if the ultimate issue is predominantly a legal one, then a lawyer may be the more appropriate candidate. Thus, if the ultimate question is whether a cause of action exists against directors or officers of a corporation for breach of a fiduciary duty, then a lawyer generally possesses the training and experience necessary to discharge his duties credibly. If it becomes necessary to address technical accountancy issues, then the lawyer-examiner may retain accountancy experts to aid in the investigation.

If the ultimate issue is predominately an accounting one, that is, if the investigation will turn on questions

concerning a sophisticated understanding of Generally Accepted Accounting Principles (GAAP) or Generally Accepted Auditing Standards (GAAS), then an accountant with a public accounting firm may be the more appropriate candidate. Of course, where necessary—such as where numerous witnesses will need to be interviewed—an accountant-examiner may retain counsel.

One Examiner—One Team

Although the board—with SEC approval—will select one individual to serve as the independent examiner, it would be naïve to believe that one person possesses the myriad of skills or the hours in the day to discharge the duties necessary to conduct the sophisticated investigation that is usually required in these situations. Thus, a board should expect that it will interface with a team of experts acting under the auspices of the independent examiner. These experts may include lawyers with SEC and corporate experience, auditors, forensic specialists, Certified Fraud Examiners (CFEs) and subject matter or content experts (business and industry experience).

For example, lawyers can be employed to aid in witness interviews and document review, while auditors and accountants with extensive accounting and SEC experience can be appointed to review the target corporation's financial statements. Additionally, computer forensic experts can be hired to identify and retrieve deleted computer files, while industry experts place all issues in the relevant business context. All these experts come together with the independent examiner to draft and present a thorough, well documented, and persuasive final report.

Conclusion

As the publicity of the use of independent examiners increases, boards should expect to be placed in situations where the SEC, a corporation's shareholders or the public demand the appointment of an independent examiner where problems have been identified. In these situations, it is incumbent on the board to select an experienced and independent examiner free from any conflicts of interest to conduct a truly independent and exhaustive investigation of the issues. The board should move quickly with the appointment, obtain governmental agency approval, and cooperate fully with the examiner. Only then will the board begin to restore public confidence in its corporation. ■

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