“Independent Investigation”
Challenges for Compliance Officers

Jim Sheehan-Chief, Charities Bureau,
New York Attorney General
Kenya Mann Faulkner- Chief Ethics and
Compliance Officer, Penn State

Ideas of “Independence” in
Corporate Organizations

• Auditor
• Board Member
• Board Committee
• Counsel
• Investigation/Investigator
• Expert
“Independent Reports” in Corporate Health Care Organizations

- The cautionary example of sexual abuse and harassment cases
- University of Southern California
- Columbia
- Dartmouth
- Rockefeller University

“Ideas of Independence” in Corporate Organizations

- What Rules Apply to each category to determine independence
- Who Determines whether independence exists?
- What are the consequences of independence?
- What procedures should exist to assure continuing independence?
- What role may compliance officers play with respect to each category of “independent?” Does it matter if the compliance officer is also an attorney?
- How can the organization preserve privilege, confidentiality, and work product protections in dealings with independents?
Olympic Committee/US Gymnastics
Independence Standards for Investigation-12/2018

• Not be providing legal advice to any individual or organization.
• Not be acting as lawyers to any individual or organization.
• Attorney-client privilege would not prevent us from releasing our factual findings.
• Complete report would be made available to the public upon the completion of the investigation.
• No one at the USOC, USAG or any other organization would have authority to direct or guide fact-finding or the content of the report.
• Ropes & Gray verified that it had not previously represented the USOC or USAG and committed that it would not represent either organization in any separate matter, however unrelated, for an extended period of years following completion of the Independent Investigation.

USOC Standards for Independence

• Board Oversight Committee of Independent Directors
• Engagement letter setting forth terms of engagement
• Agreement on access to witnesses and documents—firm had sole authority to determine what was relevant
• If anything withheld on basis of privilege, report would so state
• No proposals for reform
Auditors-the Original Independents

• “By certifying the public reports that collectively depict a corporation’s financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to the investing public. This “public watchdog” function demands that the accountant maintain total independence from the client at all times . . .” United States v. Arthur Young & Co., 465 US 805, 818 (1981)

Auditors-The Original Independents

• SEC Rules: 17 CFR Parts 210 and 240-relationships which render an auditor “not independent”—specific prohibited non-audit services
• AICPA Rules: AU 220
• “Auditor must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings . . . independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor’s report, as in the case of prospective owners or creditors”
• To be recognized as independent, he must be free from any obligation to or interest in the client, its management, or its owners.
Auditors-The Original Independents

• Even the threat of litigation between an independent auditor and its client can compromise the auditor's independence and necessitate withdrawal. US v. DELOITTE LLP, 610 F. 3d 129(DC Cir. 2010).
• AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA), AICPA PROFESSIONAL STANDARDS, CODE OF PROFESSIONAL CONDUCT 1.200.001 Independence Rule (December 15, 2014 version)

Auditor Independence

• Who determines whether independence exists? The audit firm, and the Audit Committee
• Per SOX-“The audit committee should discuss and thoroughly investigate any potential independence impairments or issues. The audit committee should also consider seeking guidance from legal counsel, the auditor and the Office of the Chief Accountant (OCA).”
• What standards are applied? AICPA Code of Professional Conduct- 1.200.001 Independence Rule]
• Specific GAAS/SEC standards
Auditor Threats to Independence-from AICPA Code of Professional Conduct

• Must be addressed either by declining engagement or through safeguards and documentation of safeguards
  – Adverse interest
  – Advocacy
  – Familiarity
  – Management participation
  – Self-interest
  – Self-review
  – Undue influence

Auditor Independence Issues

• AU-C 260 Duty to Report to Those Charged with Governance
• AU-C 250 Consideration of Laws and Regulations in an Audit of Financial Statements
• AU-C Section 240 Consideration of Fraud in a Financial Statement Audit
Auditor Independence

- What role under the Rules of Professional Conduct may counsel and the compliance officer play with respect to each category of “independent?” AU-C 250 expects that auditor may consult with in-house counsel for advice about compliance, does not mention compliance officer.
- How to preserve privilege, confidentiality, and work product protections in dealings with independent auditors? US v. DELOITTE LLP, 610 F. 3d 129 (DC Cir. 2010)

Auditor Independence

- What are the consequences of lack of independence? Auditor must evaluate independence on continuing basis and withdraw if independence cannot be assured.
- What procedures should exist to assure continuing independence? Auditor/audit committee responsibility.
- Counsel responsibility?
Board Member Independence

• What Rules Apply to board member to determine independence?
  – For nonprofits, state law (e.g., NY NFPL Section 715)
  – For profits, “disinterested director” under state law-focus on specific transactions, not status-See DGCL Section 144
  – For profits, Sarbanes-Oxley Section 301, SEC Rule ____, New York Stock Exchange listing requirements (majority of independent (“nonaffiliated” directors)
  – Independence usually means not an insider, and not subject to disqualifying conflict of interest

• Who determines whether board member is independent? Under SOX, company certifies. For nonprofits, designated officer
• What are the consequences of improper determination of independence?- for SOX, false certification.
• What procedures should exist to assure continuing independence?
• COI process and disclosures/compliance hat/record of recusals and executive sessions

Board Committee Independence

• What Rules Apply to Board Committees to determine independence
  – Audit committee-SOX and some state laws
  – Delaware-disinterest in a particular transaction: Zapata v. Maldonado (special committee of uninvolved directors)
  – Code of Conduct
• Who Determines whether independence exists?
• What procedures should exist to assure continuing independence?
• Can a compliance officer ever be “independent”?
“Independent Counsel/Independent Investigator”

- Attorney Rules of Professional Conduct are pretty much useless
- Rule 5.4 Professional Independence-Never share your fees with a non-lawyer.
- Rule 1.7 Conflict Of Interest: Current Clients: Minimal controls on the issues discussed by CPAs in AU 220

“Independent Counsel/Independent Investigator”

- Engagement letter
- Rule 1.13 Adnarim warnings
- Report to Board Committee?
- Investigative authority/process
- Written report-review, editing, distribution
- Oral or written report
- Committee should consult with compliance officer and counsel at outset
“Independent Counsel/Independent Investigator”

- The Kovel letter to investigator and/or compliance officer:
  - Assisting client under attorney’s direction
  - Scope of work
  - Specific expertise/assistance investigator brings
  - Investigator is reporting directly to attorney
  - Communications between client and investigator are privileged and confidential
  - Communications between investigator and attorney are protected and confidential
  - Attorney has control over use of investigator’s work,


- Dr. Wartell expressed concern about the fairness of a process in which people who answer to the president would investigate and resolve his claim against the president.
- Purdue University promised Chancellor Michael A. Wartell that an independent investigator acceptable to him, who was preferably (but not necessarily) an attorney, would be appointed to investigate a complaint that he had filed against Purdue’s president. “
- The attorney conducted his investigation in accordance with the specified procedures to be followed by the independent investigator, and the attorney did not inform Wartell that he was acting as Purdue’s legal counsel, as would be required under the Indiana Rules of Professional Conduct. If the attorney was not acting as Purdue’s legal counsel, then Purdue may not assert the attorney-client privilege and the work-product doctrine to prevent disclosure of the information that Wartell seeks
“Independent Counsel/Independent Investigator”

- Trimble stated that he did not inform Wartell that he was representing Purdue when he interviewed him during the investigation. This is telling, inasmuch as the Indiana Rules of Professional Conduct clearly indicate that if Trimble had been acting as an advocate for Purdue, he would have had a duty to disclose this fact to Wartell. See Ind. Professional Conduct Rule 1.13(f) . . . Trimble conducted the investigation by interviewing individuals, drafting a report, and submitting it to the Panel without disclosing an advocate role. In other words, Trimble conducted the investigation as an independent investigator.
- Purdue should be equitably estopped from invoking the attorney-client privilege and the work-product doctrine as to Wartell.

Purdue

- “The term "independent" suggests that the investigator would not be working on behalf of either party, but rather would be neutral.”
Independence-A State of Mind

- Professional rules and definitions
- Statutory rules and definitions
- SOPs and habits
- Partiality and influence

Thank You for Your Attention and The Work You Do

James Sheehan
NYAG – Charities Bureau
http://www.charitiesnys.com
James.Sheehan@ag.ny.gov

Kenya Mann Faulkner
kvm5990@psu.edu