

Execute Internal Investigations Carefully

By Jen Woods

In the wake of corporate scandals, internal investigations into corporate practices are increasingly common, and with the rise in stock option backdating, they are likely to remain so. In order to avoid criminal charges, corporate counsel should take steps to ensure that investigations are carefully executed.

Corporations can plan ahead so that they are prepared to conduct investigations before they are accused of misconduct. For instance, companies should make sure that their directors and officers (D&O) liability insurance policies cover the costs of internal investigations, which can be extremely expensive.

Companies can also research and evaluate outside law firms to determine whether they would make good potential investigators. If companies need independent counsel for investigations and they already have law firms lined up, they will ultimately save time and money.

An internal investigation is typically overseen by a company's audit committee or independent board committee. Otherwise, government agencies and auditors may question the integrity of the investigation.

Internal investigators are almost always attorneys because investigations usually involve complex legal issues. In addition, corporations are awarded attorney-client privilege if they use lawyers.

Companies frequently look to their in-house or usual outside counsel when they need help with investigations because they have already established relationships with these people. By relying on attorneys they know, corporations will most likely save money, and outside counsel have interests in maintaining their business relationships with their clients.

However, companies may be susceptible to attack if they use either their in-house or their usual outside attorneys. Government regulators are less likely to deem the findings of such investigators credible because of their established relationships with their clients.

Government agencies may also question whether in-house attorneys are providing business advice or legal advice. Another potential problem with using in-house counsel is that in-house attorneys may have been involved in the conduct being investigated. Therefore, the best way to minimize risks is to seek an independent investigator.

continued on back

The U.S. Securities and Exchange Commission (SEC) prefers that companies use independent parties for internal investigations, according to the agency's Report of Investigation and Commission Statement.

This report states that when examining the findings of an investigation, the agency considers questions such as "Did the company commit to learn the truth, fully and expeditiously? 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?"

The SEC imposes costly penalties on companies that do not conduct independent investigations. For instance, Del Global Technologies Corporation recently paid \$400,000 in penalties to the SEC as part of a settlement in an accounting fraud case. Del had hired a close personal friend to conduct the internal investigation.

While SEC penalties can be expensive, it is even more costly if a company's investigation findings are rejected all together. The cost of conducting a second investigation far surpasses \$400,000.

During an investigation, all documents and electronic data should be saved, and all written material pertaining to the investigation should also remain confidential.

Corporations undergoing internal investigations often attract the public's attention, especially if they are large companies. Therefore, corporations should develop crisis teams to prepare press releases and organize press conferences, if necessary.

Many issues are bound to arise during an internal investigation. But if a company is prepared to handle it and exercises good judgment, the investigation findings may help resolve any internal company problems.

On the Net

U.S. Securities and Exchange Commission

www.sec.gov

Expense Watch: Sarbanes-Oxley Edition

www.sox-act.org/Default.aspx?flash=1

Del Global Technologies Corporation

www.delglobal.com/cgi-bin/r.cgi/index.html