



Listen Closely: Is that a Whistle Blowing Or a Slot Machine Ringing?

Posted By [Anthony Lendez](#) and [Nicole Sliger](#) On December 1, 2010 @ 10:40 pm

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With the recent passage of the Dodd-Frank Act, whistleblowing is now an even more enticing option for individuals who are contemplating reporting possible fraud or malfeasance. Among other things, the Dodd-Frank Act establishes lucrative monetary awards for whistleblowers, creates additional antiretaliation safeguards for individuals who report violations—including the Foreign Corrupt Practices Act—and expands the scope of organizations subject to the whistleblower provisions under the Sarbanes-Oxley Act of 2002. These additional incentives and protections are expected to increase the volume of whistleblower complaints.

Under Dodd-Frank, a person who provides “original information” about a securities law violation to the Securities and Exchange Commission, which leads to a successful enforcement action resulting in monetary sanctions exceeding \$1 million, is now entitled to collect 10 to 30 percent of the total penalties imposed by the agency. Because penalties in SEC cases can amount to tens or even hundreds of millions of dollars, whistleblowers have the potential to become instant millionaires. In addition, remedies for employee whistleblowers who have been the subject of unfavorable employment actions have also been enhanced, including double back-pay with interest, compensation for litigation costs, expert witness fees and reasonable attorneys’ fees. Dodd-Frank also increases the time period during which a whistleblower may bring a complaint from 90 days, as stipulated originally under SOX, to as long as 10 years.

Dodd-Frank also broadens the scope of individuals and organizations covered by the whistleblower provisions. Notably, the whistleblower provisions now apply to all organizations, both public and private. Furthermore, Dodd-Frank expands the scope of whistleblower protections to include statistical ratings organizations (such as Moody’s and Standard & Poor’s) and subsidiaries and affiliates whose financial information is included in the consolidated financial statements of a publicly traded company.

In a related development, amendments to the U.S. Federal Sentencing Guidelines now provide organizations with an increased opportunity to reduce the penalties imposed for violations of the law if they have an “effective compliance and ethics program” in place. Under the amended guidelines, the involvement of high-level personnel in the wrongdoing will no longer be considered a mandatory disqualifying factor for a reduction in penalties if certain conditions are met, including whether the organization has promptly reported the offense to the authorities.

Because organizations that self-report can take advantage of the reduced penalties, they may find it advisable to conduct timely and thorough investigations of possible violations.

Due to the expected increase in volume of whistleblower claims, organizations will want to ensure their ethics and compliance programs encourage early internal reporting of potential wrongdoing, enable them to conduct thorough and timely investigations of allegations and result in prudent decisions regarding self-reporting. Organizations will want to assess their current processes to ensure they employ the best methods for effectively managing their whistleblower hotlines and collecting and evaluating the information. In assessing their current hotline program, organizations may want to ask themselves:

- Does our whistleblower policy encourage individuals to report possible violations of laws internally?
- Does our whistleblower hotline demonstrate sufficient confidentiality?
- Are hotline interviewers adequately trained to handle all types of calls, including callers with different ethnic backgrounds or from different countries?
- Do our whistleblower procedures enable us to distinguish between valid and specious claims?
- What types of reports should individuals within the organization, audit committee and board of directors receive and evaluate from the hotline?
- Are adequate procedures in place to ensure incidents reported to the hotline are investigated properly and in a timely manner?

Encouraging Hotline Tips

Dodd-Frank's enhanced financial bounties and protections may incentivize individuals to bypass an organization's internal compliance processes. Recognizing this concern, the SEC issued proposed Regulation 21F in November 2010. The proposed rules attempt to strike a balance between encouraging effective internal corporate-compliance programs and rewarding individuals who provide high-quality tips to the SEC that lead to successful enforcement actions. The effectiveness of these proposed rules remains to be seen.

Organizations will want to review their internal reporting policies and mechanisms to ensure individuals can and are encouraged to report matters to the organization. If the perception among potential users is that the organization's hotline program is ineffective or "just for show," individuals may refrain from using the hotline because they feel it is a waste of time. To encourage use of the hotline, organizations should consider how convenient it is to access the hotline. The hotline should operate around-the-clock, as most calls are made outside normal business hours. Because third parties are also eligible to participate in the bounty program under Dodd-Frank, the hotline's reach should be aligned with this new legislation to include third parties, such as customers, vendors, shareholders, competitors, business partners and associates of employees. To instill confidence in the hotline program, frequent communications should take place through various media and training programs on confidentiality, anonymity and the hotline reporting process.

Because of the enhanced rewards and protections offered to whistleblowers by Dodd-Frank, some organizations are considering creative ways to incentivize individuals to report possible

violations of laws internally. For example, some are establishing internal bounties for reporting potential misconduct or promoting recognition (anonymously) in employee newsletters as a means of “advertising” tips that were rewarded for helping the organization stop certain ongoing violations.

Receiving Hotline Tips

The handling of an initial call to a hotline is critical. Oftentimes, this may be the one and only chance to obtain information about possible wrongdoing. Due to the small window of opportunity for communication, great care should be taken when handling incoming calls. Gathering as much information as possible will help organizations assess claims more efficiently and result in a more expeditious resolution of claims.

Utilize live, skilled interviewers. Organizations should use live interviewers who can elicit complete and relevant information from callers. Interviewers should have the requisite language skills so they can handle callers of different ethnic backgrounds or from other countries. Skilled interviewers can sometimes get an initial sense of whether the reported claim is legitimate. While it certainly does not supplant the need for a thorough assessment, a well-qualified interviewer can occasionally identify individuals who may be reporting false claims by evaluating their statements or verbal cues. Whether an organization uses internal resources or external third-party service providers to handle hotline calls, it should ensure that the proper controls are in place to preserve confidentiality. This will help encourage individuals to use the organization’s internal reporting processes.

Assessing Hotline Tips

Another important aspect of a hotline program is how tips are evaluated to determine whether a formal investigation is warranted. If an organization is unable to swiftly distinguish between tips that require a formal investigation and those that do not, it increases the likelihood that an individual with knowledge of the conduct will contact the authorities before the organization can react.

Establish and execute prearranged procedures. Organizations should have defined roles and responsibilities for those who will be assigned to evaluate hotline tips. The level of involvement by senior management, the board of directors and the audit committee will depend on several factors, including the type of allegation, the position of the employee involved, the frequency of abuse, the estimated loss to the organization and the opportunity for further abuse. Certain complaints, such as claims involving senior management, financial reporting issues and significant asset misappropriation, ordinarily should be reported directly to the board of directors and/ or the audit committee. Organizations may want to develop a report distribution matrix to help them identify the roles and responsibilities of the various parties involved in the assessment process and track the status of claims reported to the hotline.

An organization’s assessment procedures should outline the action steps and protocols necessary for the timely resolution of claims, including which types of reports require immediate escalation. For example, complaints involving possible threats of violence or business interruption warrant a rapid response. Those in charge of the hotline should have the phone numbers of key personnel in the event that urgent matters arise.

Employ controls to reduce the risk of management override. Simply having certain protocols and procedures in place may be ineffective if there are no internal controls to ensure these mechanisms are not overridden. Proper management- override controls are essential to protect the organization from accusations of covering up improper behavior, especially when allegations involve senior management. To mitigate this risk, organizations should implement a dual-reporting system where reports on hotline tips are disseminated to at least two recipients, including a member of the audit committee.

Investigating Hotline Tips

The objective of this phase is to further evaluate the validity of the claim without impugning the reputation of the accused. Organizations will want to have prearranged investigative protocols to avoid panic-stricken, knee-jerk reactions to allegations of improper conduct that cause them to approach investigations in a disorganized manner. Also, care should be taken to ensure the “race-to-report” atmosphere which may be created by Dodd-Frank does not lead to premature self-reporting before the alleged violations can be investigated adequately.

Evaluate the situation. Prior to launching a formal internal investigation, steps should be taken to further corroborate or disprove the allegations. This preliminary assessment should include gaining an understanding of the scope, origin and reach of the alleged misconduct. Having a “triage process” in place to prioritize and investigate hotline tips is an effective way to manage potential violations to ensure legitimate ones are identified and addressed appropriately. This preliminary assessment will allow the organization to better determine the nature and amount of resources needed to carry out a formal investigation, if necessary. Identifying legal, accounting and investigative experts upfront can save valuable time (and money).

Plan the investigation. If a formal investigation is deemed necessary, organizations should determine the scope of the investigation based on the results of the preliminary assessment. A lead person should be identified to direct the investigation. In selecting a lead person, it is important to consider whether members of management or the board of directors are subjects of the investigation. The investigative team should identify upfront the specific objectives of the investigation, the responsibilities of team members and the work product to be produced. While interviews are being planned and investigative roles are being assigned, steps also need to be taken to limit continuation of the alleged misconduct. The organization will also want to consider whether internal or external counsel should be retained for the investigation. While the use of an organization’s counsel or accountants may appear to make the most sense since they are already familiar with its operations and finances, it is important to consider how using such resources will affect the appearance of independence and whether any potential conflicts may exist. Experienced counsel can help ensure the evidence uncovered during the investigation will stand up in court, if necessary. Moreover, with the established and evolving law around whistleblower protections, it is important for organizations to engage counsel who understand the new regulations, particularly those relating to the anti-retaliation provisions. Organizations can mitigate the consequences of these risks by retaining counsel experienced in conducting investigations with knowledge of the relevant regulations.

Conduct interviews. Prior to conducting interviews, the order in which interviewees will be questioned should be planned. Generally, interviews of the accused should not occur at the outset

until sufficient information has been gathered and pertinent questions have been developed. Also, care should be taken regarding the extent of information disclosed during interviews, as it could tip off interviewees about the issues under investigation and provide an opportunity for them to be the first to report the organization to authorities.

At the close of the interview, the interviewee should be reminded about the confidential nature of the discussion. Given the enhanced anti-retaliation protections provided by Dodd-Frank, this message will need to be crafted carefully so the interviewee does not misinterpret this request as an effort to prevent them from contacting the government. Outside counsel can help determine how best to phrase this request.

Consider the consequences of the investigation. Once the investigation is underway, the organization will need to determine, in consultation with counsel, the extent of appropriate public disclosure and its possible impact. Notifications previously made to internal and external parties, such as independent auditors, will need to be revisited, to apprise them of the results of the investigation and any planned remediation efforts.

In addition, the question of self-reporting needs to be evaluated carefully. In certain instances, organizations have a legal obligation to self-report conduct that may be a violation of law. In other situations, there may be significant pressure and incentives to self-report, remediate and cooperate with the government. Consultation with counsel is necessary to determine the most prudent plan of action.

Secure data and maintain documentation. From the original hotline tip to final disposition of the investigation (if any), the information gathered should be memorialized and secured properly. A centralized system for documenting the results of the investigation and any disciplinary actions is recommended. Organizations should develop a records retention policy for whistleblower reports, complaints and any investigation results. It may also be advisable to lengthen the time to retain records so it is aligned with the expanded statute of limitations of Dodd-Frank and other pertinent retention regulations applicable to the organization. Having proper documentation in place will also help disprove allegations that claims were not handled properly.

Assessing the Hotline Program

Organizations should periodically review the effectiveness of their hotline program to ensure it is being used effectively and determine whether employees feel it is a trustworthy reporting mechanism. Organizations can accomplish this in various ways, including, for example, conducting anonymous surveys, holding focus groups and requesting feedback on the hotline program during exit interviews.

The more generous bounties and enhanced protections provided by Dodd-Frank are expected to increase the volume of whistleblower complaints. This, combined with the potential reduction in penalties available to organizations that self-report, provide a renewed determination to ensure that organizations encourage internal and early reporting of potential violations so they can be investigated in a timely manner and prudent decisions can be made about any necessary self-reporting. Armed with the proper procedures, organizations will be better prepared to mitigate risks and reduce costs of potential violations.

Anthony Lendez is a partner in the New York office of BDO Consulting and co-national director of the Financial Reporting Disputes and Investigations practice. Nicole Sliger is a director in the New York office of BDO Consulting.

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