SEC Whistleblowing Program
Post- Dodd-Frank: A Review for Internal Auditors

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SEATTLEU
ALBERS SCHOOL OF BUSINESS AND ECONOMICS
2002 Persons of the Year

Cynthia Cooper
Worldcom

Colleen Rowley
FBI

Sherron Watkins
ENRON
Have you ever been exposed to any situation where you suspect that your employer (or client) might be in violation of the SEC, or any other standard, as it relates to any issue that might affect: financial accounting & reporting, internal controls, audit risk, disclosures, etc.?
Whistleblowers and the law

- False Claim Act
  - Any person with knowledge of false claims or fraud (against the federal government) may bring a lawsuit in his own name and the US.
  - The claimant is awarded 15 – 20% of the $ proceeds
  - 70% of all this claims: whistleblowers 1987-2013 (38.9 billion recovered)


- Sarbanes Oxley (2002)
  - Sherron Watkins
  - publicly listed companies
  - If retaliation:
    - Civil protection: Reinstatement, back pay, compensatory damages, etc.
Whistleblower: As defined by Dodd-Frank

• Any individual who provides information relating to a “possible” violation (that has occurred, is ongoing or is about to occur) of the securities laws to the SEC.

• Lawson v. LMR (March 4, 2014)
  • Expands protections to employees of contractors and subcontractors of public firms
Dodd-Frank

- Dodd-Frank (2010)
  - 21F: Securities Whistleblower Incentives and Protections
    - effective August 12, 2011).
  - Established the Office of the Whistleblower (OWB)
  - SEC has the authority to enforce all the provisions of Dodd-Frank
    - Prohibits retaliation against whistleblowers
    - Reviews restrictive agreements
    - Bounty program to compensate whistleblowers
Dodd-Frank: Anti-Retaliation

- SEC identifies and closely monitors whistleblowers complaints alleging retaliation in response to employees reporting possible violations
  - Internally or to the SEC
- Paradigm capital: Hedge Fund
  - A culpable trader reported to the SEC
  - He was removed from his trading desk and put on leave, and later terminated him.
  - Settled: $2.2 million, Whistleblower got: >$$600,000
- The case highlights SEC commitment to any anti-retaliatory provisions
Dodd-Frank: Restrictive Agreements

• SEC can bring its action against restrictive agreements or engaging in other practices, to interfere with individuals’ ability to report potential wrongdoing

• 21F-17(a) provides that “[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications.”
Dodd-Frank: Bounty Program

• Awards whistleblowers for 10-30% of sanctions when whistleblower voluntarily provides original information about a violation of the federal securities laws that leads to a successful enforcement action in which the SEC recovers monetary sanctions over $1 million
• Possible violation
• Monetary sanctions: penalties, disgorgement, and interest
Dodd-Frank: Bounty Program

• Exclusions:
  • Culpability (only if convicted)
  • Unreasonable delay in reporting
  • Interference with internal compliance systems
  • Lawyers
Dodd-Frank: Bounty Program

• $142 million to 34 whistleblowers
  • 2016: $57 million in awards
    • One award was $30 million

• SEC sanctions led by whistleblowers:
  • $935 million
Deutche Bank: Inflated value of Credit Derivatives
  • Two whistleblowers awarded: $16.5 million
  • Ben-Artzi: declined his portion ($8.25 million) and gave it back to the shareholders

Monsanto: Inflated sales
  • Internal and then to the SEC
  • Deloitte fought the allegation.
  • Whistleblower got $22 million
Dodd-Frank: Anti-retaliation

- **IGT**: fired an employee that reported internally and to the SEC that the cost accounting model was distorting the Financial Statements. The company investigated and fired the employee.
  - **$500 in fines**

- **Anheuser Bush**: stopped an employee from communicating with SEC. The employee had also reported internally concerns about improper payments to government officials. **Settled: $6 million**
Dodd-Frank: Anti-retaliation

• Home Street Bank: improper hedge accounting and later took illegal steps to impede employees from talking to the SEC about it.

Settled: $500,000
BlueLinx: severance agreements that required outgoing employees to waive their rights to monetary recovery in the event they filed a charge or complaint with the SEC or other federal agencies.
  • Fine: $265,000

BOA: Merrill Lynch: used language in severance agreements that operated to impede employees from voluntarily providing information to the SEC Fine: $415 million
• **HealthNet**: severance agreements that required outgoing employees to waive their ability to obtain monetary awards from the SEC’s whistleblower program as a condition of receiving severance payments and other consideration from the company. **Fine: $340,000**
Internal Controls

• SEC
  • Financial Reporting & Audit Task Force (FRAud Group):
    • Internal controls and audit failures
  • Broken Windows policy: Technical, non-fraud violations
  • Pre-IPO: Internal controls
  • Prioritizes Internal Controls: deficient internal controls include:
    • Inadequate staffing, delays, incomplete testing
    • Potential for error is a substantial risk
    • Significant deficiencies are enough
    • There does not need to be a material weakness or an error
      • Magnum Hunter: Internal Auditor Fined $40,000 and suspended
      • Marrone Bio:$ 1.75 million
      • Stein Mart: $800,000
      • Sand Ridge Energy, New Star, KBR, etc.
**Dodd-Frank: Whistleblowing**

- Tips and calls: “Fire-house” of fraud tips

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Kimbrough: Whistleblowing Post Dodd-Frank
Dodd-Frank: Whistleblowing

• 65% of whistleblowers are insiders
  • 80% report internally first
• 25% report anonymously
• Most common: broker-dealer investments, Ponzi-schemes, accounting irregularities, internal control violations.
OWB: Whistleblower Tips by Allegation 2013-2016
Latest events: Whistleblower or not?

• **Asadi v GE Energy**: Foreign Corrupt Practices Act violation
  • Asadi reported to supervisor
  • Received negative performance evaluations and later fired
  • He filed in Texas alleging Dodd-Frank whistleblower violation
  • Dismissed in District Court: he is not a whistleblower
  • **5th Circuit affirmed: He is NOT a whistleblower.**

• **Berman v Neo@Ogilvy**: Accounting fraud, internal controls, GAAP, etc.
  • Berman was fired. He reported to the audit committee.
  • Filed in NY. DC dismissed.
  • **2nd circuit: March 10, 2017: He is a whistleblower**
Whistleblower or not?

• Headed to the Supreme Court
  • Solicitor general will argue the case

• *Lawson v. FMR*: employees of contractors of public companies, including employees of accounting and audit firms, are protected under the [whistleblower protection provision of the Sarbanes-Oxley Act (SOX)](https://www.sec.gov/comments/sarbox/1142632943-1142632943_wr.pdf). *Lawson* recognizes the critical roles that auditors and accountants play in exposing fraud, and the importance of affording these critical gatekeepers robust whistleblower protection.
In *Berman v Neo@Ogilvy*

- 2nd Circuit argued:

“Some potential whistleblowers, the court reasoned, will choose to report only to their employer, with the hope of ending any wrongdoing and limiting the likelihood of retaliation that may accompany reporting to a government agency. More importantly, certain categories of employees, particularly auditors and attorneys, are required by law to make internal reports *before* reporting to a government agency. Such employees would be deprived of almost all Dodd–Frank whistleblower protection if required to report to the Commission.”