

## **Corporate Compliance: Sarbanes-Oxley Act of 2002**

### **Sec. 301 (4). “Complaints” and Sec. 806. “Protection for employees. . . who provide evidence of fraud”**

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#### ***Responding to complaints, including those from “whistleblowers.”***

The Sarbanes-Oxley Act of 2002 (the “Act”), Sec. 301, provides that the board of directors of public companies shall have an audit committee which shall establish procedures for the “...receipt, retention, and treatment of complaints received...” regarding “...accounting, internal accounting controls, or auditing matters...” and further, “...the confidential, anonymous submission by employees...of concerns regarding questionable accounting or auditing matters.”

The spirit of this provision is to allow employees, former employees, and others with particular knowledge of financial, accounting, or auditing irregularities or improprieties to register such irregularities with appropriate parties who are in a position to act upon such submissions, and for employees, without fear of retaliation.

Sec.806, in part, adds protections for “employees” who provide information relating to fraud against shareholders including federal mail fraud, wire fraud, securities fraud, any SEC rule, or any provision of federal law relating to fraud against shareholders.

Underneath the umbrella of complaints, therefore, are special provisions for employees (and former employees who were terminated as the result of submitting a complaint) whose complaints are taken to fall under these civil action provisions. It behooves the audit committee, therefore, to take all complaints seriously, and complaints from employees are particularly sensitive.

#### **Complaints**

While the Act clearly stipulates complaints that are financial in nature, the Act does not go so far as to further qualify “complaints.” Until further interpretations by the SEC and/or the Oversight Board, the meaning of complaints should be taken broadly to include those that may logically have impact on the financial well-being of the company which in turn may have impact on shareholder value.

Complaints, valid or not, may also be malevolent. Malevolent complaints may be malicious or spurious, and they may be cloaked with a desire to intentionally cause harm to the company—such as to cause its share price to decline. Internet message boards have been a favorite forum for lodging complaints. Annual meetings have also been a forum for lodging complaints. Complaints may arise in many ways, and they may be directed at company-related individuals and/or at the company itself. The nature of complaints may vary with respect to the company, industry, and geographic location (including those operating outside the U.S. and those foreign companies operating in the U.S. under U.S. public company regulatory authority).

#### **Evaluating Complaints**

It is difficult to evaluate complaints and their merits until each respective complaint is lodged and ultimately investigated. Clearly, the audit committee is charged with setting up procedures for handling complaints, notwithstanding that many if not most complaints will not come to the attention of the audit committee via prescribed ways.

Complaints may come from employees, former employees (including those recently fired), subcontractors, vendors, and clients, and many others who have relevant information to impart. There is no perfect way to evaluate the quality of a complaint, but tests may be applied to review and pre-qualify a complaint with respect to pre-investigation priorities.

### **Complaint Screening**

The three basic elements to a complaint include: the informant, the message, and implicated individuals.

#### *The Informant*

In addition to the above characteristics, the individual and his/her method of communication may have varying levels of “revelation.” The informant may name himself, or not. The communication mode may be direct as prescribed by the audit committee, or not. For example, an unidentified caller to the company’s night answering machine, notwithstanding the audit committee’s protocol, does not rule out that the call was from an employee. Named informants suggest a higher level of seriousness. Named informants who submit complaints through an attorney suggest an even higher level of seriousness.

#### *The Message*

The informant’s message may be communicated in vague, cloaked, and/or ambiguous ways. Such cloaking does not rule out that the message is indeed a serious complaint. Assertions may range from vague to very specific. Assertions that are detailed as to date, time, and place, and those where there is documented evidence, suggest an even higher level of priority. Nevertheless, complaints can be categorized relative to such informant and message variables.

#### *Implicated Individual*

The complaint may be lodged against the company, its employees, its management, its advisors, and/or other associated entities. Again, vague or no reference to the target of the complaint may carry a lower priority for follow up. On the other hand, reference to specific individuals, with detail about duties, responsibilities, and/or management activities, for example, help define a complaint that suggests validity.

Complaints from an unnamed informant, communicating a vague message and vaguely targeted, may carry less priority than those coming from a named informant, who gives a specific message, identifying specific individuals or entities, with support documentation.

It is up to the audit committee to decide the degree to which each complaint should be followed up. All complaints should be logged regardless where they come from. Of course, complaints can only be logged provided they get recognized and properly channeled.

### **Policy Considerations**

Other provisions of the Act provide for a code of conduct, an ethics statement, and internal controls. Any policy concerning complaints dovetails with these provisions. Audit committees should establish a policy with procedures on how employees may register complaints. The policy should also provide that any inbound communications that appear to be complaint-like in nature must be forwarded to a designated administrator. Such complaints should be forwarded to an outside advisor to the audit committee, not only to attest that all complaints are being duly logged, but also to preserve confidentiality and anonymity especially if lodged by employees, whether that fact is known or not. Serious complaints are likely to be lodged in stages, with successive communications. Complaints from individuals who become known to the company’s advisor, and who assist with an investigation as to the merits, need the preservation of confidentiality. Investigations that emerge to suggest sanctions under the Act need to be weighed by the audit committee for appropriate action steps and appropriate coordination with the company’s auditor, legal counsel, and/or special counsel. All policies and procedures should be reviewed by outside counsel especially as other regulatory rules may apply given the nature of the company.