

The Shadow Path [PODCAST]

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On this episode of The Bracewell Sidebar, hosts Matthew Nielsen and Seth DuCharme discuss the role of the outside auditor as part of investigations with guest Jeff Ferguson. Jeff is a partner in Ernst & Young's forensic and integrity services practice, with more than two decades of experience in fraud and forensic investigations.

Tell us about the auditor's role in internal investigations known as shadow investigations?

When we have an audit client that has a concern about some kind of fraud — maybe there's a whistleblower complaint or something like that and our audit client needs to perform an investigation — we as the audit firm perform what's called a shadow investigation. What that means is the audit team will bring in the forensics specialist from the audit team. What we do is we evaluate the investigation team as well as the investigative process, such that when the investigative team comes to some conclusions as to who did what or who all was involved, we as the auditors can rely upon those conclusions. So, a shadow investigation really is the evaluation of the investigative team and the investigative process.

Why is it necessary for you to get involved on behalf of the audit team?

A lot of times when a shadow investigation is called for, we're dealing with allegations that could affect the C-level client. When we're dealing with that, we're looking at management integrity, and that's something as the auditors that we have to rely upon. The auditors take representations from management of their audit clients that the financial statements are correct and things of that nature. Relying on management integrity is fundamental to any audit. If we're dealing with questions of management integrity or questions as to the accuracy of the financial statements, the allegations involved or incorrect financials, we have to be able to rely on the investigative conclusions. Therefore, we need to make sure that the investigative process was adequate.

When you're doing these types of investigations, how often are you doing them contemporaneously with some outside agency conducting an investigation? Are you doing it either in preparation for that or with an awareness that the ultimate

work product that you might be producing will at some point be part of a deliverable to a regulatory agency or an investigative agency, or is it principally for internal purposes?

A shadow investigation is for internal purposes. We are a part of the audit team. Our work papers become audit work papers. We are not presenting findings or conclusions or anything like that to any outside agencies. We're working strictly with our audit teams and our professional practices group. The subject matter that we're focused on is the quality of the investigative process. There are various ways that an investigation can start, some of which include inquiries by the government or inquiries by regulators that may be the beginnings of an audit committee investigation. In those instances, the investigative team that the client would hire — the outside attorneys — are presenting findings potentially to regulators or to the government.

What are the things you see that set an investigation up for failure versus what you see that sets it up for success, vis-à-vis getting the auditor comfortable with the end result?

To me, it doesn't all depend on how you start, but a lot of it depends on how you start. If you make some missteps in the beginning, it can be really hard to recover. We see companies that have an issue, they hire their corporate counsel, and those people pull in their white-collar attorneys to do the investigation, and off they go. That can be fine in a lot of instances. There's nothing necessarily wrong with that, but there could be instances where that's not preferable, such as if you have allegations against a CFO, a CEO or someone like that, and it's issues that do touch the financials or the disclosures. At that point, it would be preferable to bring in an independent counsel that isn't relying on the company for fees annually. That helps us get over the question of objectivity. Are they going to be objective, or are they going to not really want to report something bad on the CEO for whom they've been working for the last decade?

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