



GIBSON DUNN

*Managing Internal Audit
and Investigations*

November 9, 2021

MCLE Certificate Information

- Most participants should anticipate receiving their certificate of attendance in eight weeks following the webcast
- Please direct all questions regarding MCLE to CLE@gibsondunn.com

Today's Presenters



[Michael Diamant](#)

Partner
Washington D.C. Office
Tel: +1 202.887.3604
MDiamant@gibsondunn.com



[Patrick Stokes](#)

Partner
Washington D.C. Office
Tel: +1 202.955.8504
PStokes@gibsondunn.com



[Oleh Vretsona](#)

Partner
Washington D.C. Office
Tel: +1 202.887.3779
OVretsona@gibsondunn.com



[Ella Capone](#)

Senior Associate
Washington, D.C. Office
Tel: +1 202. 887.3511
ECapone@gibsondunn.com

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The Roles of Internal Audit and the Legal Department

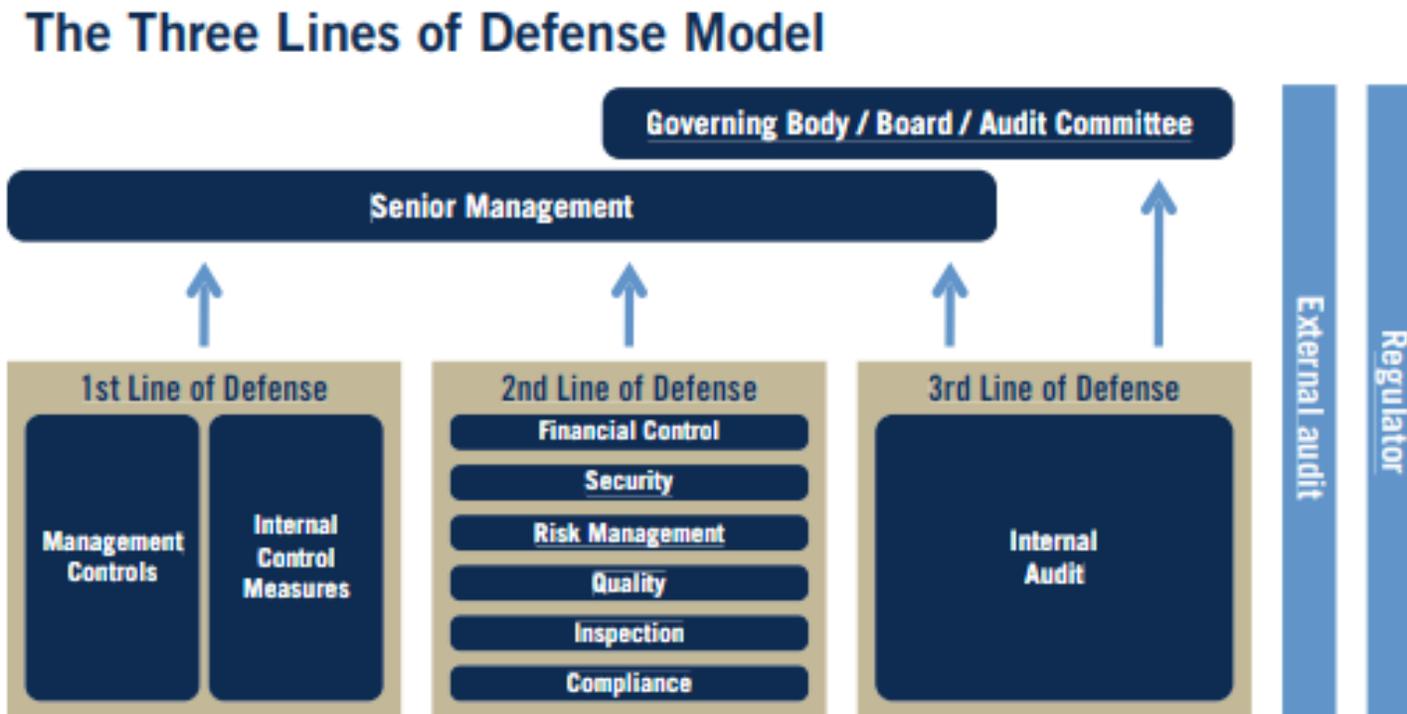
Complementary Objectives

Internal audit and legal departments have complementary objectives, which may intersect when an audit examines issues around the company's compliance with the law.

Internal Audit	Legal Department
Independent, objective assurance and advisory services provider.	Provides legal advice to organization.
Conducts audits ranging from operational to those required by law. Audits may focus on particular functions, processes, or controls.	Legal advice can include regulatory expectations, the organization's approach to mitigating risk, and the adequacy of the organization's compliance programs.
May include individuals with legal backgrounds, but focus is on checking the organization's work and not interpreting legal requirements.	Interprets legal requirements relevant to an organization's work and processes.

The Importance of Internal Audit

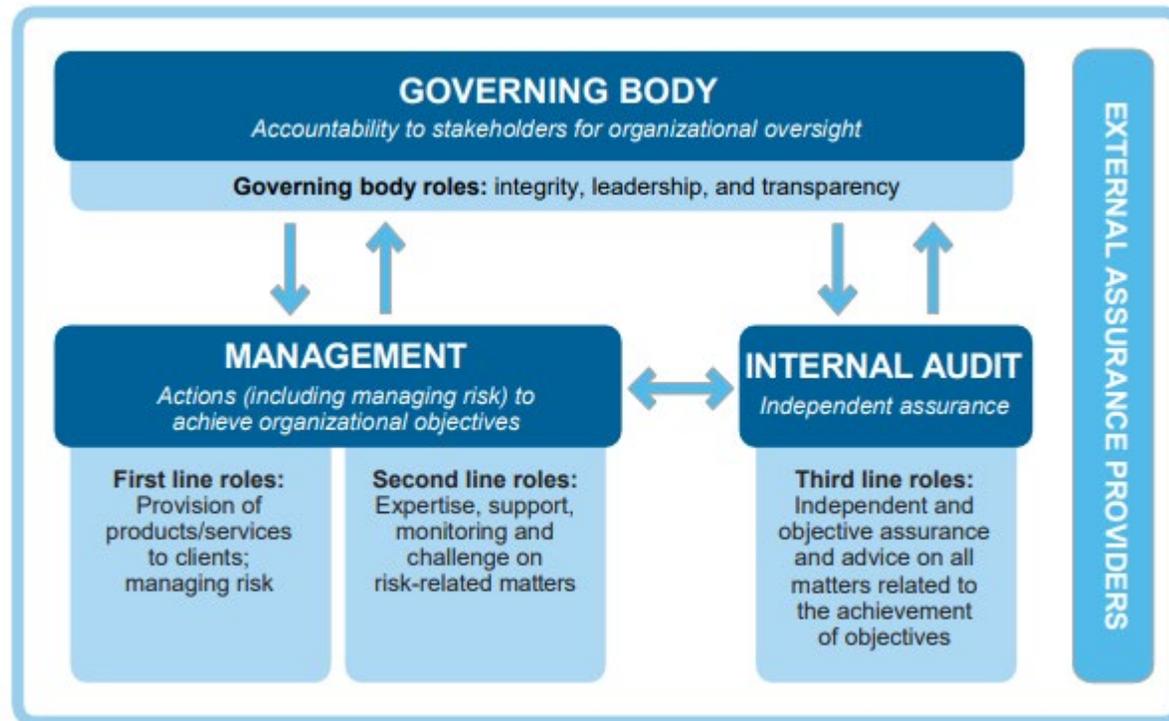
The Three Lines of Defense Model (2013)



IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control (Jan. 2013), adapted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41.

The Importance of Internal Audit

The Three Lines of Defense Model (2020)



The IIA's Three Lines Model, An Update of the Three Lines of Defense (July 2020)

The Importance of Internal Audit

“A comprehensive, independent, and objective testing or audit function . . . ensures that entities are aware of where and how their programs are performing and should be updated, enhanced, or recalibrated to account for a changing risk assessment or sanctions environment, as appropriate.” —OFAC

“Voluntary audit programs play an important role in helping companies meet their obligation to comply with environmental requirements. Such assessments can be a critical link, not only to improved compliance, but also to improvements in other aspects of an organization’s performance.” —EPA

“[B]anks should have an internal audit function with sufficient authority, stature, independence, resources and access to the board of directors. Independent, competent and qualified internal auditors are vital to sound corporate governance.” —Basel Committee on Banking Supervision

“Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law . . . minimally require . . . [that the organization] take reasonable steps . . . to ensure that the organization’s compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct.” —U.S.S.G. §8B2.1(b)(5)(A)

“As a company’s risk for FCPA violations increases, that business should consider increasing its compliance procedures, including due diligence and periodic internal audits.” —DOJ/SEC FCPA Resource Guide

The Importance of Internal Audit

DOJ Criminal Division Evaluation of Corporate Compliance Programs June 2020 Update

Prosecutors should evaluate whether “internal audit functions [are] conducted at a level sufficient to ensure their independence and accuracy,” as an indicator of whether compliance personnel are in fact empowered and positioned to “effectively detect and prevent misconduct.”

- How do companies determine where and how often internal audit will undertake audits?
- How are audits carried out?
- What types of audits would have identified issues relevant to the misconduct?
- Did those audits occur and what were the findings?
- What types of relevant audit findings and remediation progress have been reported to management and the board regularly?
- How have management and the board followed up?
- How often does internal audit conduct assessments in high-risk areas?

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Audit Activities Can Raise Complex Legal Issues

Privilege

Audit work generally is not privileged.

- Definition of legal professional privilege: the privilege (or right) of a client not to disclose confidential communications between client and attorney that were made for the purpose of seeking or providing legal assistance or advice.
 - Legal professional privilege protects communications, not facts.
- Generally speaking, internal audit reports and work papers are not protected by privilege:
 - Attorney-client privilege does not attach if the audit is not directed by counsel.
 - Work product protection does not apply if the audit was conducted in the ordinary course of business rather than “in anticipation of litigation.”
- Internal audit reports may be subject to discovery.

Privilege

“At bottom, the respondent’s claim to privilege appears to be premised on a gimmick: exclude counsel from conducting the internal investigation but retain them in a watered-down capacity to ‘consult’ on the investigation in order to cloak the investigation with privilege. Unfortunately for the respondent, this sort of ‘consultation lite’ does not qualify the Audit Report for the protections of the attorney-client privilege.”

United States v. ISS Marine Servs., Inc., 905 F. Supp. 2d 121, 129–30 (D.D.C. 2012)

“While the director of Internal Audit testified that he is an attorney, he is not an attorney for CUNY, and the report, which he wrote with a CUNY examiner who is not an attorney, contains nothing that reflects ‘legal research, analysis, conclusions, legal theory or strategy.’”

State ex rel. Murray v. Baumslag, 134 A.D.3d 451, 452, 21 N.Y.S.3d 51, 52 (2015)

A pharmaceutical company’s director of quality assurance’s “‘assessment’ and ensuing report . . . are responsive, at a minimum, to the discovery request seeking internal audits.”

In re Digitek Prod. Liab. Litig., 2010 WL 519860, at *3 (S.D. W. Va. Feb. 10, 2010)



Legal Interpretation

Audit work may require application of legal standards.

- Audit work may cover not only compliance with internal policies, procedures, and standards, but also areas that touch on compliance with legal standards.
- Legal standards may be nuanced or the interpretation thereof may have minimal, subjective, or outdated guidance.
- A company's internal legal position may be different from the position it would take in an adversarial action or investigation.
- Auditors should be careful, therefore, not to include wording that could be construed as legal conclusions, which may be incorrect or may differ from the legal department's conclusions.



Questions about Compliance



Audit work may result in findings that raise questions about legal compliance.

- An audit finding suggesting that a company is not in compliance with a legal requirement could trigger mandatory disclosures or self-reporting.
- If provided to the government, audit findings that raise questions about legal compliance could be used as the basis of enforcement actions, particularly if remedial steps have not been taken.

Audit work may identify deficiencies in compliance programs.

- Any deficiency needs to be addressed.
- The adequacy of a compliance program is a significant topic in government investigations and enforcement actions.

Ongoing Investigations and Remedial Actions

Audit work may implicate topics that are currently in the government's focus or otherwise are already being investigated.

- Audits may concern topics under investigation.
 - This may include confidential topics not known outside of the legal department.
 - Audits of such topics could implicate witnesses or subjects of the investigation.
- Audits may concern government-mandated remedial actions.
 - If such actions are being taken pursuant to stipulated penalty provisions, audit findings could result in financial liability.



Internal Audit and Government Actions

Internal audit may identify potential illegal activity at early stages and strong audit programs may be credited in enforcement actions.



Fresenius Medical Care (2019): The resolution documents alleged that Fresenius's legal, compliance and Internal Audit functions failed to detect and prevent bribery in certain countries, particularly in West Africa, despite numerous red flags. However, the documents also noted that Internal Audit did identify certain issues relating to the company's dealings with foreign officials in Mexico and Spain.



Statoil (2006): Statoil's Internal Audit department identified potential violations of anti-bribery laws related to a consulting contract with an Iranian Official and raised concerns with senior management. It was in the process of finalizing a letter to the Board of Directors when the contract was disclosed by the media.

Internal Audit and Government Actions

On the other hand, internal audit reports are routinely requested in government investigations and audit findings or failures may be used to support charges.



WPP (2021): The SEC alleged that the company “lacked meaningful coordination between its legal and internal audit departments” and management of its international operations. Management allegedly did not provide adequate oversight to ensure remediation of deficiencies identified by internal audit.



Deutsche Bank

Deutsche Bank (2021): The SEC alleged that the company did not timely remediate internal audit findings that raised concerns about the use of a third-party business development consultant.



Novartis (2020): The SEC highlighted internal audit findings of alleged control deficiencies in clinical trials carried out by one subsidiary, and in equipment placements by a former subsidiary



Herbalife Nutrition Limited (2020): The SEC quoted email exchanges between Board Members and IA regarding 2016 internal audit findings allegedly showing excessive hospitality expenses by Herbalife employees in China

Internal Audit and Government Actions

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Mobile TeleSystems (2019): The resolution documents cited MTS's failure to implement adequate internal accounting controls and to enforce the controls it had in place. Among other deficiencies, MTS was cited for lacking a sufficient internal audit function to ensure corporate assets were not used to bribe foreign officials, and failed to conduct adequate internal audits to detect and prevent criminal activity.



Stryker Corp. (2018): The SEC alleged that the company's internal controls were insufficient to detect the *risk* of improper payments in India, China, and Kuwait. Among other issues, the SEC alleged that an internal forensic review of Stryker's Indian subsidiary identified no supporting documentation for many high-risk transactions, and that Stryker's Chinese subsidiary used sub-distributors that were not vetted, approved, or trained as required by company policy.



Panasonic (2018): Internal audit identified risks from payments to government officials and third party providers.

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How to Get the Most out of Audit and Legal Working Together

Protecting Privilege

Consider whether audits should be conducted with legal oversight when sensitive topics are at issue.

- The audit concerns topics of an ongoing investigation or a likely forthcoming investigation.
- The audit concerns the implementation of legally mandated compliance measures.
- The audit concerns the interpretation of legal requirements, particularly when such interpretation is not settled.



In some areas, even privileged documents may be subject to review by regulators.

Best Practices for a Working Relationship



Consider implementing best practices for a working relationship between audit and legal.

- Coordinate with legal early in the process on topics such as scope and advisability of an audit, and later in the process to review draft reports and other work product.
 - Deconflict with legal in the event an investigation or remedial exercise is underway.
- Involve the legal department if an audit addresses compliance with the law.
 - Implement a policy with defined escalation steps, particularly if indicia of fraud, corruption, or some other legal violation is discovered.
 - Involve legal in the audit process or segregate particular issues for investigation.

Best Practices for a Working Relationship



Consider implementing best practices for a working relationship between audit and legal.

- Work with the legal department to avoid interpreting unclear legal standards.
- Focus on factual statements rather than subjective interpretations suggestive of misconduct.
- Use precise wording in audit reports.
 - Words that address legal exposure, risk, and liability can be taken out of context.
 - Avoid sweeping or overly broad statements.
 - Be clear about if/when findings are limited.
- Ensure that remedial steps are practical and workable, and there is a process to follow through on any action items.

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Upcoming Webcasts & Other Resources

Gibson Dunn Webcasts

Upcoming Programs

[What's Next: Spoofing and Manipulation in Commodities and Derivatives Markets](#)

- **Date:** Thursday, December 09, 2021
- **Time:** 12:00 PM Eastern Standard Time
- **Duration:** 1 hour, 15 minutes

Recent Programs

- [Compliance Monitors: Everything that you wanted to know but were afraid to ask](#)
- [Negotiating Closure of Government Investigations: NPAs, DPAs, and Beyond](#)
- [Economic Espionage and Intellectual Property Theft: Trends and Developments with Threats and Enforcement](#)
- [National Security Enforcement: Developments and Trends](#)