Law and Internal Auditing

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Sources: IIA Material

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Overview

- Fiduciary Duties of Audit Committee
- Duties and Functions of Internal Auditors
- Liabilities of Auditors
- Auditor-Client Privilege
- Auditor Testimony
Duties and Functions of Audit Committee

Internal Audit Results
(Page 2 of 4)

<table>
<thead>
<tr>
<th>Code</th>
<th>Element</th>
<th>Nonconformance</th>
</tr>
</thead>
<tbody>
<tr>
<td>M</td>
<td>4.9</td>
<td>Auditee was uncertain about process/unable to clearly answer questions on how process is implemented.</td>
</tr>
<tr>
<td></td>
<td>4.9</td>
<td>OWI identifies quality record not produced by the process and the significant process steps do not produce a quality record.</td>
</tr>
<tr>
<td></td>
<td>4.16</td>
<td>Auditee produced a video tape as a quality record which was not identified in the OWI as a quality record.</td>
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<tr>
<td></td>
<td>4.9</td>
<td>OWI states that AA approves the operating budget. Auditee indicated that the AA only provides comments.</td>
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<td></td>
<td>4.9</td>
<td>Discrepancy between flowchart and narrative procedure.</td>
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<tr>
<td></td>
<td>4.16</td>
<td>Flowchart identifies competitive and non-competitive procurements, but narrative procedure limited to competitive.</td>
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<td></td>
<td></td>
<td>Employees hired subsequent to the release of HCP 3410-4, Employee Training and Qualifications, were not trained.</td>
</tr>
</tbody>
</table>

Recommendations of the ICFA NTF

- Recommendations concerning Inter-continental links:
  - ICFA should encourage the provision of some considerable extra bandwidth, especially across the Atlantic.
  - ICFA participants should make concrete proposals, (such as recommendation to increase bandwidth across the Atlantic, approach to QoS, co-operation with disciplines and agencies, etc.)
  - The bandwidth to Japan needs to be improved.
  - Integrated end-to-end connectivity is a critical requirement, to be emphasized to cooperate with academic and research networks.

August 10, 1998  ICFA.SCIC Report #1  Matthias Kasaian
Auditor-Client Privilege

Couch v. United States

- No Accountant-Client Privilege exists under federal law
- The 5th Amendment may NOT be invoked to prevent the production of business records.
**Auditor-Client Privilege**

**FEDERAL**

*United States v. El Paso Co.*

- The Attorney-Client Privilege does NOT apply to work prepared by accountants

**Exceptions - STATE**

*Southern Bell Tel. & Tel. Co. v. Beard*

- Some states recognize an auditor privilege
Auditing the Legal Process
Objectives

Increase the effectiveness
Decrease costs
Address basic controls and control tests
Suggest substantive tests
Discuss basic content of an audit report
The Myths

We cannot audit the legal process

Because

The following prohibit the audit
- Legal Counsel
- Charter
- Other Reasons

Truth

These usually are not sufficient justifications for precluding an audit of the legal process
You can audit around sensitive documents, including...

- Correspondence
- Memorandums
- Draft Pleadings
- Video/audio records
The Preliminary Review
Flowchart the process
Conduct a walk through
Review

- Document Handling
- Legal Reporting
- Billing
- Staffing
- Other related matters
Controls
Legal services should be subject to periodic bidding

Routine legal services should be brought in-house
Legal engagements should be evidenced by a written contract.
Substantive Tests
Analytical Tests

Detailed Tests

Including trend analysis and benchmarking intra-company, intra-industry, and inter-industry.
The Report

- Avoid accusing counsel
- Have sufficient examples
- Support positions
- Limit distribution
Conclusion

Summary

- Preliminary Review
- Run Analytics
- 250 step Audit Program
- Test Data to File Content

Questions

Comments
Intellectual Property Auditing the Process
The first three are afforded considerable protection under federal law, both in the United States and other countries.
The Scope of the Audit

- Geographical Location
- Types of Intellectual Property
- Organizational Department
- Specific Products

Key Notes – Good to Know!
When determining the scope of the audit, the team should solicit the input from executive management, in order to gain insight on areas that contain high concentrations of intellectual property.
After identifying where the value and risks related to intellectual property are harbored, it should be much easier to determine the scope of the audit.
Diagramming and Flowcharting - The Organization of Personnel -

Executive Management

Intellectual Property Personnel (Internal and external) assigned along territorial lines

Territory A  Territory B  Territory C  Territory D

Intellectual Property Personnel by Territory
The R & D Department conducts research and produces new developments

Is a particular development unique?

- No: Document finding and store as appropriate
- Yes: A

Documenting Discoveries Internally Developed
Control Design and Review
- Internal Control Questionnaire -

• What is management’s overall philosophy?

• What steps does management take to ensure that intellectual property rights are adequately protected?

• How frequently does management test controls dealing with intellectual property?

• Can management identify key personnel assigned a responsibility of developing and maintaining intellectual property right?
Key Notes – Good to Know!

The organization may not have any policies addressing intellectual property right. Under normal circumstances, this should be considered a major control weakness that warrants immediate corrective action taken by management.

The auditor may want to procure a copy of policies and procedures used by other organizations within the relevant industry. Benchmarking corporate practices against those within the industry may provide valuable insight to the auditor.
Are ownership claims valid?

Testing Rights and Obligations

Can management produce documents of ownership?

Is some ownership shared with a third party?

Have ownership rights been transferred to third parties?

Areas of concern when testing rights and obligations assertions
Areas of concern when testing presentation and disclosure assertions

- Are ownership claims valid?
- Are rights fairly presented?
- Are claims by third parties divulged on the financial statements?
- Is pending litigation disclosed?
Are intellectual property liabilities recorded?

Testing Completeness

Are disbursements accurate?
Are liabilities reflected on the financial statements?
Are the liabilities accurate?

Areas of concern when testing the completeness assertion
Illustrative Distribution List of the Audit Report