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THE EMERGING RESPONSIBILITIES OF THE
INTERNAL AUDITOR

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THE INSTITUTE OF INTERNAL AUDITORS
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INTRODUCTION

GOOD AFTERNOON-

IT IS A PLEASURE TO BE HERE TODAY AND TO BE ABLE TO ADDRESS SUCH A SIGNIFICANT SEGMENT OF ONE OF OUR COUNTRY'S FASTEST GROWING PROFESSIONS. MANY IMPORTANT CHANGES HAVE TAKEN PLACE IN THE CORPORATE COMMUNITY OVER THE PAST FEW YEARS WHICH I BELIEVE WILL ULTIMATELY HAVE AS GREAT AN IMPACT ON YOUR PROFESSION AS ANYTHING WHICH HAS HAPPENED SINCE THE INSTITUTE OF INTERNAL AUDITORS WAS FOUNDED IN 1941. NONE OF THESE CHANGES ARE LIKELY TO HAVE A GREATER IMPACT THAN THE EMERGING FOCUS ON CORPORATE GOVERNANCE AND CORPORATE ACCOUNTABILITY.

TREMENDOUS PRESSURES HAVE BEEN BUILDING FOR SOME TIME NOW FOR MEASURES TO BE INSTITUTED TO CORRECT WHAT MANY PERCEIVE TO BE WIDESPREAD ABUSES OF CORPORATE POWER AND ABDICATIONS OF

CORPORATE AND PUBLIC RESPONSIBILITY BY MANAGEMENT, DIRECTORS AND OTHERS. THESE PRESSURES HAVE IN TURN PRODUCED A NEW EMPHASIS ON HIGH STANDARDS OF CORPORATE AND PERSONAL CONDUCT AND GREATER ACCOUNTABILITY FOR INDIVIDUALS WHO DIRECT THE AFFAIRS OF BUSINESS ENTERPRISES. INCREASINGLY, THOSE WHO MUST FULFILL THESE RISING EXPECTATIONS WILL BE LOOKING TO INTERNAL AUDITORS TO CONTRIBUTE THEIR SKILLS AND TALENTS TO THE TASK OF MEETING THEIR GROWING RESPONSIBILITIES.

THE REPORT OF THE METCALF SUBCOMMITTEE OF THE UNITED STATES SENATE WAS PERHAPS A HARBINGER OF THE IMPORTANT ROLE THAT INTERNAL AUDITORS WILL BE EXPECTED TO FULFILL IN THE FUTURE WHEN IT NOTED THAT INTERNAL AUDITORS, WORKING WITHIN CORPORATIONS, "CAN SERVE AN IMPORTANT FUNCTION IN PROMOTING CORPORATE

ACCOUNTABILITY, AS WELL AS EFFICIENCY." IT IS ALSO SIGNIFICANT THAT IN A REPORT WHICH WAS GENERALLY VERY CRITICAL WITH RESPECT TO ACCOUNTING MATTERS, ONE OF THE FEW PLAUDITS WAS RESERVED FOR THE IIA.

I WAS VERY PLEASED TO NOTE THAT JUST YESTERDAY THE BOARD OF DIRECTORS OF YOUR ORGANIZATION APPROVED FOR PUBLICATION THE INSTITUTE'S "STANDARDS FOR THE PRACTICE OF INTERNAL AUDITING." I BELIEVE THAT THE ESTABLISHMENT OF APPROPRIATE PROFESSIONAL STANDARDS IS AN IMPORTANT STEP IN THE GROWTH OF ANY DISCIPLINE, AND I TRUST THAT THE STANDARDS YOU HAVE AND WILL SET, REFINED BY COMMENT AND EXPERIENCE, WILL SUBSTANTIALLY ENHANCE INTERNAL AUDITING PROFESSIONALISM. IN ESTABLISHING AND MAINTAINING STANDARDS FOR YOUR PROFESSION, YOU NEED TO BE CONTINUOUSLY SENSITIVE TO THE CHANGING EXPECTATIONS OF THE LARGER

SOCIETY AND THEIR IMPACT ON APPROPRIATE STANDARDS
AND ON THE RESPONSIBILITIES OF CORPORATE MANAGEMENT.

THE MAINTENANCE OF PROFESSIONALISM

YOU HAVE BEGUN THE PROCESS OF ESTABLISHING
APPROPRIATE ETHICAL AND TECHNICAL STANDARDS FOR
THE PRACTICE OF YOUR PROFESSION. YOU MUST ALSO
CONTINUE TO SEEK RECOGNITION FOR THOSE STANDARDS
AND FOR YOUR PROFESSION BY SPEAKING OUT ON KEY
ISSUES AND BY BECOMING INVOLVED IN THE PUBLIC
AND PRIVATE SECTOR INITIATIVES WHICH AFFECT YOUR
RESPONSIBILITIES.

JUST AS PUBLIC ACCOUNTING PROFESSIONALS HAD
TO WORK TO ERASE THE IMAGE OF BOB CRATCHETT WITH A
GREEN EYESHADE, SO MUST INTERNAL AUDITORS STRIVE
TO ALTER THEIR IMAGE, WHICH IN THE PAST HAS ALL TOO

OFTEN BEEN ONE OF A PERPETUAL COUNTER OF THE PETTY CASH FUND.

THE IMPORTANT FUNCTIONS WHICH INTERNAL AUDITORS PERFORM ARE ALREADY BEING REFLECTED IN THE CAPABLE INDIVIDUALS BEING ATTRACTED TO YOUR PROFESSION. AS YOU WORK TO EXPAND YOUR SPHERE OF PROFESSIONAL RESPONSIBILITY, RECOGNITION OF THE CAREER QUALITY OF INTERNAL AUDITING WILL CONTINUE TO GROW.

INCREASING RESPONSIBILITIES OF INTERNAL AUDITORS AND EXPANDING RELIANCE ON YOUR WORK BY CORPORATE DIRECTORS AND MANAGEMENT WILL ALSO BRING INCREASED VISIBILITY. HIGHLY VISIBLE PROFESSIONALS ARE INVARIABLY SUBJECT TO BOTH REWARDS AND RISKS. THE REWARDS WILL COME IN THE FORM OF INCREASED RECOGNITION, STATURE AND COMPENSATION. THE RISKS WILL

FOLLOW IN THE FORM OF HEIGHTENED EXPECTATIONS ON THE PART OF THOSE WHOM YOU SERVE AND, IN SOME INSTANCES, CRITICISM FOR FAILING TO MEET THOSE EXPECTATIONS.

YOU SHOULD, THEREFORE, ALSO TAKE CARE TO INSURE THAT INTERNAL AUDITING DOES NOT FIND ITS INSTITUTIONAL FRAMEWORK CALLED INTO QUESTION IN THE KIND OF SOBERING MANNER EXPERIENCED BY SOME OTHER PROFESSIONS IN RECENT TIMES. AS, I AM SURE, ALL OF YOU ARE AWARE, DESIGNING AND INSTALLING AN ACCOUNTING SYSTEM IS OFTEN A SIMPLE TASK COMPARED TO THE DIFFICULTIES OF ENSURING THAT THE SYSTEM IS ADEQUATE UNDER CHANGING CIRCUMSTANCES. A PROFESSIONAL "SYSTEM" IS MUCH THE SAME. IT MUST CONTINUE TO GROW AND CHANGE TO MEET THE NEEDS CREATED BY A DYNAMIC ENVIRONMENT.

THE INSTITUTE HAS MADE A COMMENDABLE START BY CONSTITUTING THE CIA EXAMINATION AS THE ACCEPTED MEANS FOR ESTABLISHING BASIC PROFESSIONAL CREDENTIALS AND BY RECOGNIZING CONTINUING EDUCATION AS THE MECHANISM FOR MAINTAINING THOSE CREDENTIALS. THE INCLUSION OF AN EXTERNAL REVIEW REQUIREMENT FOR INTERNAL AUDIT DEPARTMENTS UNDER YOUR NEWLY-ADOPTED STANDARDS IS ALSO AN IMPORTANT ELEMENT OF THESE QUALITY CONTROL EFFORTS. EVERY MEMBER OF THE INSTITUTE NOW HAS A PERSONAL AND PROFESSIONAL RESPONSIBILITY TO SEE THAT THE STANDARDS ARE ADHERED TO AND THAT THE MOMENTUM GENERATED BY THESE INSTITUTIONAL INITIATIVES CONTINUES.

THE IIA ITSELF ALSO HAS A RESPONSIBILITY TO SPEAK OUT ON KEY ISSUES WHICH AFFECT ITS MEMBERSHIP. THE INSTITUTE'S PROFESSIONAL PRACTICE COMMITTEE WAS

ESTABLISHED IN DECEMBER OF LAST YEAR TO FURTHER SUCH PURPOSES, BUT SO FAR HAS APPARENTLY KEPT A LOW PROFILE. THE INSTITUTE WAS CONSPICUOUSLY ABSENT, FOR INSTANCE, FROM THE AICPA'S AUDIT COMMITTEE HEARINGS HELD THREE WEEKS AGO. THE VOICE OF YOUR PROFESSION MUST SPEAK IN ORDER TO BE HEARD.

ON THE OTHER HAND, THERE ARE ALSO DANGERS IN BECOMING TOO PARTISAN AN ADVOCATE. A PROFESSIONAL ORGANIZATION IS DIFFERENT FROM A TRADE ASSOCIATION IN THIS REGARD. YOU SHOULD CERTAINLY PRAISE AND PROTECT YOUR PROFESSION WHEN THAT IS WARRANTED, BUT YOU MUST ALSO CRITICIZE IT WHEN THAT IS CALLED FOR AND SERVE AS A CATALYST FOR CONTINUAL PROGRESS AND CHANGE. TO BE PERSUASIVE, YOUR POSITIONS MUST ADDRESS ALL AFFECTED INTERESTS AND BE BALANCED, OBJECTIVE AND RESPONSIBLE.

RESPONSIBILITIES OF THE INTERNAL AUDITOR

I THINK IT IS APPROPRIATE THAT, IN ESTABLISHING THE FIRST WIDELY-ACCEPTED STANDARDS FOR INTERNAL AUDITING, THE FOCUS HAS BEEN ON THE TRADITIONAL ROLE OF THE INTERNAL AUDITOR AND HIS RELATIONSHIP TO CORPORATE INTERNAL CONTROLS AND INFORMATION SYSTEMS. FOR A TIME IT APPEARED THAT YOUR PROFESSION WAS HAVING SOMETHING OF AN IDENTITY CRISIS, AS THE FIELD OF "OPERATIONAL AUDITING," WITH ITS EMPHASIS ON MANAGEMENT EFFICIENCY AND PROGRAM EVALUATION, CAUGHT THE ATTENTION OF CORPORATE MANAGERS. WHILE I BELIEVE THAT OPERATIONAL AUDITING WILL CONTINUE TO HAVE A LEGITIMATE PLACE IN THE SCHEME OF THINGS, I ALSO BELIEVE THAT IT IS THROUGH TRADITIONAL INTERNAL AUDIT FUNCTIONS THAT INTERNAL AUDITORS WILL ACHIEVE ENHANCED PROFESSIONAL RECOGNITION AND WILL

PROVIDE THE MOST VALUABLE SERVICES TO ALL LEVELS
OF CORPORATE MANAGEMENT.

ANOTHER PROBLEM FOR YOUR PROFESSION IS THAT
INTERNAL AUDITORS ARE INEVITABLY, BY THE VERY NATURE
OF THEIR WORK, PLACED IN THE SOMEWHAT SCHIZOPHRENIC
POSITION OF HAVING SPLIT RESPONSIBILITIES. AS YOUR
NEWLY ESTABLISHED PROFESSIONAL STANDARDS RECOGNIZE,
DIRECT COMMUNICATION WITH THE BOARD OF DIRECTORS IS
AN ESSENTIAL ELEMENT IN MAINTAINING INDEPENDENCE IN
RELATION TO THE ACTIVITIES SUBJECT TO AUDIT. THE REAL-
ITIES OF CORPORATE OPERATIONS, HOWEVER, ALSO DICTATE
THAT THE INTERNAL AUDITOR SERVE MANAGEMENT IN FULFILLING
ITS PARTICULAR RESPONSIBILITIES. THE FINESSE AND SKILL
WITH WHICH THIS DUAL ROLE IS FILLED WILL BE AN IMPORTANT
DETERMINANT OF THE EFFECTIVENESS OF THE INTERNAL AUDIT
STAFF.

I BELIEVE THERE ARE TWO PARTICULAR STEPS WHICH YOU, AS INTERNAL AUDITORS, CAN TAKE WHICH WILL HELP TO MAKE THESE DUAL RESPONSIBILITIES WORK IN YOUR FAVOR.

FIRST, YOU SHOULD USE WHATEVER RESOURCES ARE AT YOUR DISPOSAL TO ENCOURAGE YOUR CORPORATE EMPLOYERS TO ESTABLISH AN AUDIT COMMITTEE MADE UP OF INDEPENDENT OUTSIDE DIRECTORS. REPORTING TO A BOARD, OR A COMMITTEE OF THE BOARD, MADE UP OF CORPORATE MANAGERS WEARING THEIR DIRECTOR'S HATS DOES LITTLE TO STRENGTHEN THE INDEPENDENCE OF THE INTERNAL AUDIT STAFF. THE HEIGHTENED SENSE OF PUBLIC RESPONSIBILITY WHICH AN INDEPENDENT AUDIT COMMITTEE BRINGS TO THE CORPORATE GOVERNANCE PROCESS ALSO HELPS INSURE THAT SKILLS SUCH AS YOUR OWN ARE BROUGHT TO BEAR ON THOSE PROBLEMS IN WHICH THE OWNERS OF THE BUSINESS - THE PUBLIC SHAREHOLDERS - HAVE THE GREATEST INTEREST.

SECOND, YOU SHOULD WORK TO HELP ASSURE THAT THE DIRECTOR OF INTERNAL AUDITING IS PRIMARILY RESPONSIBLE TO SOMEONE IN MANAGEMENT WITH SUFFICIENT AUTHORITY NOT ONLY TO PROVIDE INDEPENDENCE, BUT ALSO TO INSURE THAT COOPERATION IS ACCORDED TO THE INTERNAL AUDIT STAFF BY ALL ELEMENTS OF THE ORGANIZATION SUBJECT TO AUDIT. THE APPROPRIATE EXECUTIVE TO OVERSEE THE WORK OF THE INTERNAL AUDIT STAFF WILL VARY FROM COMPANY TO COMPANY, BUT SHOULD NOT, EXCEPT UNDER MOST UNUSUAL ORGANIZATIONAL CIRCUMSTANCES, BE THE CHIEF FINANCIAL OFFICER OR CHIEF ACCOUNTING OFFICER. IT SHOULD, NEVERTHELESS, BE AN EXECUTIVE AT A LEVEL HIGH ENOUGH IN TOP MANAGEMENT TO MINIMIZE THE RISK OF PRESSURE TO PREVENT ISSUANCE OF EVEN THE MOST CRITICAL REPORT OR TO IMPEDE ACCESS TO THE BOARD. HIS AUTHORITY SHOULD

ALSO BE SUFFICIENT THAT REPORTS ARE ACCORDED APPROPRIATE ATTENTION BY THOSE IN A POSITION TO TAKE ACTION ON THE RECOMMENDATIONS OF THE INTERNAL AUDITORS.

ONE OF THE MOST IMPORTANT TASKS INTERNAL AUDITORS ARE GOING TO BE ASKED TO PERFORM -- AND ONE WHICH I ENCOURAGE YOU NOT ONLY TO ACCEPT, BUT TO ACTIVELY SEEK -- IS THAT OF ASSISTING AUDIT COMMITTEES IN DISCHARGING THEIR OVERSIGHT FUNCTIONS. AS AUDIT COMMITTEES BECOME MORE COMMONPLACE AND TAKE ON A WIDER RANGE OF FUNCTIONS, YOUR PROFESSION CAN FULFILL A VITAL ROLE IN HELPING TO ESTABLISH AND MONITOR INTERNAL CONTROL SYSTEMS, AND IN PROVIDING AN INDEPENDENT SOURCE OF INFORMATION ON WHICH AUDIT COMMITTEES CAN BASE THEIR DECISIONS.

IN AIDING THE AUDIT COMMITTEES, IT IS IMPORTANT THAT THE INTERNAL AUDIT DIRECTOR HAVE THE ABILITY --

AND WHEREVER POSSIBLE THE RESPONSIBILITY -- TO COMMUNICATE DIRECTLY WITH THE AUDIT COMMITTEE. ALTHOUGH INTERNAL AUDITORS CAN AND SHOULD SERVE MANAGEMENT, THEIR VITALITY AND INITIATIVE SHOULD NOT BE STIFLED BY ARTIFICIAL LIMITATIONS ON ACCESS TO THE AUDIT COMMITTEE OR THE FULL BOARD. IN FACT, THE INTERNAL AUDITORS SHOULD HAVE A DIRECT REPORTING RELATIONSHIP WITH THE AUDIT COMMITTEE, AN ORGANIZATIONAL STEP THAT SEVERAL LARGE COMPANIES HAVE SUCCESSFULLY TAKEN.

INTERNAL CONTROL AND THE FOREIGN CORRUPT PRACTICES ACT

ONE OF THE AREAS IN WHICH AUDIT COMMITTEES AND OTHERS WILL BE SEEKING SUBSTANTIAL ASSISTANCE IS IN COMPLYING WITH THE "FOREIGN CORRUPT PRACTICES ACT OF 1977" WHICH THE PRESIDENT SIGNED INTO LAW LAST DECEMBER 19. NOT ONLY DOES THAT LAW MAKE IT GENERALLY UNLAWFUL

TO BRIBE FOREIGN GOVERNMENT OFFICIALS, IT ALSO CONTAINS FAR-REACHING PROVISIONS REQUIRING THE MAINTENANCE OF BOOKS, RECORDS AND AN ADEQUATE SYSTEM OF INTERNAL ACCOUNTING CONTROL BY PUBLIC COMPANIES.

IN ADDITION TO CARRYING OUT THEIR RESPONSIBILITIES UNDER THE ACT, MANY PUBLIC COMPANIES HAVE REACTED TO WIDESPREAD PUBLIC DISCLOSURES OF QUESTIONABLE AND ILLEGAL CORPORATE ACTIVITIES BY CONDUCTING INTERNAL INQUIRIES AND ESTABLISHING EMPLOYEE CODES OF CONDUCT.

MANY CORPORATIONS ARE NOW SEEKING WAYS TO OBTAIN SOME ASSURANCE OF COMPLIANCE WITH THEIR LEGAL RESPONSIBILITIES, AND IN BOTH OF THESE AREAS [I HAVE MENTIONED -- INTERNAL CONTROL AND CODES OF CONDUCT -- THERE IS A SIGNIFICANT PART TO BE PLAYED BY CORPORATE INTERNAL AUDIT STAFFS AND BY THE INSTITUTE OF INTERNAL AUDITORS ITSELF.

SEVERAL RESPONSIBLE ORGANIZATIONS, INCLUDING THE AICPA'S COHEN COMMISSION, HAVE STRONGLY SUGGESTED THAT THE PUBLIC INTEREST WOULD BE SERVED BY A REQUIREMENT FOR CORPORATE REPORTING ON THE ADEQUACY OF INTERNAL CONTROL. COMMENTATORS HAVE MADE VARIOUS SUGGESTIONS FOR IMPLEMENTING THESE RECOMMENDATIONS, SUCH AS REPORTS ISSUED BY THE AUDIT COMMITTEE, THE CHIEF FINANCIAL OFFICER OR THE DIRECTOR OF INTERNAL AUDITING HIMSELF.

I CANNOT TELL YOU WITH ANY CERTAINTY AT THIS POINT WHICH ELEMENT OF CORPORATE MANAGEMENT WILL HAVE RESPONSIBILITY FOR SUCH A REPORT, BUT IT IS VIRTUALLY CERTAIN THAT REPORTING ON INTERNAL CONTROL WILL BE A REALITY FOR PUBLIC COMPANIES AT SOME POINT IN THE NEAR FUTURE. IT IS EVEN MORE CERTAIN THAT INTERNAL AUDITORS WILL BE HEAVILY INVOLVED IN THE PROCESS.

INTERNAL ACCOUNTING CONTROL IS AN AREA WHERE THE DEPTH AND BREADTH OF KNOWLEDGE OF THE INTERNAL AUDITOR SHOULD BE RIVALED BY NO ONE, INSIDE OR OUTSIDE THE COMPANY. IN ADDITION TO HIS ON-GOING ROLE AS A MONITOR OF THE SYSTEM, THE INTERNAL AUDITOR WILL BE CALLED UPON TO CONDUCT A COMPREHENSIVE EXAMINATION OF THE SYSTEM, TO EVALUATE THAT SYSTEM AND TO MAKE RECOMMENDATIONS FOR MODIFICATIONS AND IMPROVEMENTS.

BEFORE PUBLIC REPORTING CAN BECOME WHOLLY WORKABLE, HOWEVER, STANDARDS MUST BE IN PLACE AGAINST WHICH MANAGEMENT CAN JUDGE WHETHER OR NOT THE CORPORATE SYSTEM IS SUFFICIENT TO PROVIDE REASONABLE ASSURANCE OF COMPLIANCE WITH THE PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT, AND ANY OTHER RELEVANT REQUIREMENTS. AN AICPA SPECIAL ADVISORY COMMITTEE, COMPOSED PRINCIPALLY BY

CORPORATE FINANCIAL OFFICERS AND INTERNAL AUDITORS, HAS BEEN WORKING TO PRODUCE A DOCUMENT WHICH WILL PROVIDE A BASIC FRAMEWORK OF SUCH STANDARDS. THE COMMITTEE HAS INDICATED THAT THE CRITERIA BEING DEVELOPED ARE INTENDED TO PROVIDE GUIDANCE FOR MANAGEMENT IN EVALUATING ITS INTERNAL ACCOUNTING CONTROLS, AND THAT THE REPORT WILL BE USEFUL IN EVALUATING COMPLIANCE WITH THE ACCOUNTING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT.

THE SUBSTANTIAL BODY OF KNOWLEDGE ALREADY ACCUMULATED BY THE PUBLIC ACCOUNTING PROFESSION CONCERNING THOSE ASPECTS OF INTERNAL CONTROL DIRECTLY RELATED TO PUBLISHED FINANCIAL REPORTS IS CLEARLY REFLECTED IN THE CURRENT DRAFT OF THE SPECIAL ADVISORY COMMITTEE'S REPORT. IT THUS APPEARS

THAT WE WILL SOON HAVE FAIRLY COMPREHENSIVE GUIDELINES WITH RESPECT TO THE "ADEQUACY" OF INTERNAL CONTROL FOR PURPOSES OF PREPARING ANNUAL AND INTERIM FINANCIAL STATEMENTS, PRESS RELEASES ON EARNINGS, AND THE LIKE.

OTHER CONSIDERATIONS IN COMPLYING WITH PROVISIONS OF THE NEW LAW ARE NOT NEARLY SO WELL DEFINED, HOWEVER. ONLY THE MOST FUNDAMENTAL PARAMETERS WILL BE AVAILABLE, THEREFORE, TO ASSIST MANAGEMENT - AND INTERNAL AUDITORS - IN GAUGING THE ADEQUACY OF INTERNAL CONTROLS WITH RESPECT TO:

- THE SAFEGUARDING OF CORPORATE ASSETS FROM LOSS DUE TO NATURAL ELEMENTS, THEFT AND MISAPPROPRIATION;

- EXECUTION OF TRANSACTIONS IN ACCORDANCE WITH MANAGEMENT AUTHORIZATIONS -- THAT IS, THE CONDUCT OF BUSINESS IN LINE WITH CORPORATE POLICIES AND THE DIRECTIVES OF MANAGEMENT; AND
- PERIODIC COMPARISON OF THE ASSETS RECORDED ON THE BOOKS WITH ASSETS ACTUALLY PRESENT.

IN THE LONG RUN IT IS UNLIKELY THAT THESE FUNDAMENTAL PARAMETERS ALONE WILL BE SUFFICIENT TO PROVIDE CORPORATE MANAGEMENT WITH THE GUIDANCE NECESSARY TO FULFILL ITS PUBLIC RESPONSIBILITIES. I URGE THIS INSTITUTE TO DRAW UPON THE TALENTS AND RESOURCES OF ITS MEMBERS TO BEGIN TO FLESH OUT THE BASIC CONCEPT OF AN ADEQUATE SYSTEM OF INTERNAL CONTROL. THE ORGA-

NIZATION REPRESENTING THE INTERNAL AUDITING PROFESSION SHOULD BRING ITS EXPERTISE TO BEAR IN AREAS OTHER THAN THOSE TRADITIONALLY WITHIN THE PROVINCE OF YOUR COUNTERPARTS IN PUBLIC ACCOUNTING. THOSE ASPECTS OF INTERNAL CONTROL WHICH ARE RELATED TO THE SAFEGUARDING OF ASSETS AND TO THE EXECUTION OF TRANSACTIONS IN ACCORDANCE WITH MANAGEMENT'S DIRECTIVES, IT SEEMS TO ME, ARE AREAS WHICH INTERNAL AUDITORS ARE PARTICULARLY WELL EQUIPPED TO ADDRESS.

EVERY SYSTEM OF INTERNAL CONTROL IS, OF COURSE, SUBJECT TO THE VAGARIES OF HUMAN BEHAVIOR. THAT IS WHY I BELIEVE THAT A NECESSARY COMPLEMENT TO AN ADEQUATE INTERNAL CONTROL SYSTEM IS A CORPORATE CODE OF CONDUCT WHICH PROVIDES OFFICERS AND EMPLOYEES WITH REASONABLE GUIDANCE AS TO THE TYPES OF

BEHAVIOR WHICH ARE CONSIDERED ACCEPTABLE IN CONNECTION WITH BUSINESS DEALINGS ON BEHALF OF THE CORPORATION.

THE CORPORATE CONDUCT CODE SHOULD BE AN IMPORTANT CONSIDERATION IN SETTING THE SCOPE OF INTERNAL AUDIT. I BELIEVE THERE ARE TWO FACTORS WHICH ARE CRITICAL IN ASSURING THAT SUCH CODES SERVE THEIR INTENDED PURPOSES.

FIRST, TOP MANAGEMENT AND THE AUDIT COMMITTEE SHOULD INSIST THAT EMPLOYEES IN RESPONSIBLE POSITIONS CONFIRM ANNUALLY THEIR COMPLIANCE WITH THE CORPORATION'S CODE OF CONDUCT. THAT AFFIRMATION SHOULD BE IN WRITING AND THE INTERNAL AUDIT STAFF SHOULD REVIEW THE RESPONSES AND MAKE ANY FOLLOW-UP INQUIRIES WHICH APPEAR TO BE APPROPRIATE.

SECOND, INTERNAL AUDITORS SHOULD BE SENSITIVE TO THE POSSIBLE RISKS OF CIRCUMVENTION OF THE INTERNAL CONTROL SYSTEM AND SHOULD DESIGN REASONABLE AND APPROPRIATE AUDIT TESTS TO HELP IDENTIFY SUCH INSTANCES.

BOTH OF THESE STEPS SHOULD BE A PART OF THE ROUTINE TASKS OF THE INTERNAL AUDIT DEPARTMENT IN MONITORING COMPLIANCE WITH THE CODE AND IN REPORTING TO THE AUDIT COMMITTEE CONCERNING THE RESULTS OF THAT MONITORING PROCESS.

WORKING WITH THE INDEPENDENT AUDITOR

ANOTHER AREA WHERE THE TALENTS OF INTERNAL AUDITORS MAY BE FRUITFULLY EMPLOYED IS IN THE RELATIONSHIP BETWEEN THE CORPORATION AND ITS INDEPENDENT PUBLIC ACCOUNTANTS.

THERE IS ONE ASPECT TO THAT RELATIONSHIP WHICH IS SELDOM FOCUSED ON. SELECTION OF AN INDEPENDENT PUBLIC ACCOUNTING FIRM IS A TASK WHICH AUDIT COMMITTEES MUST OCCASIONALLY FACE. AS PRACTITIONERS OF A PARALLEL DISCIPLINE, YOUR INSIGHTS AND RECOMMENDATIONS SHOULD BE OF CONSIDERABLE ASSISTANCE TO THE AUDIT COMMITTEE IN ENGAGING COMPETENT INDEPENDENT PUBLIC ACCOUNTANTS WHO CAN PROVIDE HIGH QUALITY SERVICE AT REASONABLE COST.

INCIDENTALLY, WHILE I AM ON THE SUBJECT, I WOULD LIKE TO MENTION A PART OF THIS SELECTION PROCESS WHICH CONCERNS ME. THERE IS AN UNFORTUNATE TENDENCY, I THINK, FOR OUTSIDE DIRECTORS GENERALLY, AND AUDIT COMMITTEE MEMBERS IN PARTICULAR, TO ADOPT A SOMEWHAT DEFENSIVE POSTURE WITH RESPECT TO SELECTION OF THE

INDEPENDENT AUDITOR. A PART OF THIS POSTURE IS OFTEN A MISPERCEPTION THAT "BIGGER IS BETTER." SMALLER ACCOUNTING FIRMS, JUST LIKE SMALLER INTERNAL AUDIT DEPARTMENTS, ARE GENERALLY CAPABLE OF PERFORMING COMPETENT AUDIT WORK. SIZE BEARS NO NECESSARY CORRELATION TO QUALITY. REGARDLESS OF THE SIZE OF THE FIRMS BEING CONSIDERED, HOWEVER, THE AUDIT COMMITTEE SHOULD SEEK THE ADVICE OF THE INTERNAL AUDIT DIRECTOR TO ASSIST IT IN ASKING THE RIGHT QUESTIONS AND IN EVALUATING THE CREDENTIALS OF THE PROSPECTIVE OUTSIDE AUDITORS.

IN ADDITION TO ASSISTING THE AUDIT COMMITTEE SELECT AN OUTSIDE AUDITOR, THE INTERNAL AUDITOR CAN ALSO PROVIDE DIRECT ASSISTANCE TO HIS EXTERNAL COUNTERPART.

AS AUDITS BECOME MORE COMPLEX AND PRESSURES TO REDUCE AUDIT COSTS GROW, BOTH THE INDEPENDENT AUDITOR

AND CORPORATE MANAGEMENT WILL BE LOOKING TO INTERNAL
AUDIT STAFFS FOR RELIEF. THERE IS CONSIDERABLE POTENTIAL,
I THINK, FOR A MORE RESPONSIBLE ROLE FOR INTERNAL
AUDITORS IN THE EXTERNAL AUDITING PROCESS. IN THE
ROLE OF MONITOR OF THE INTERNAL CONTROL SYSTEM, THE
INTERNAL AUDITOR CAN SUBSTANTIALLY REDUCE THE WORK
OF THE OUTSIDE AUDITOR BY RAISING THE RELIABILITY
OF INTERNAL CONTROLS, THUS PERMITTING THE INDEPENDENT
PUBLIC ACCOUNTANT TO INCREASINGLY RELY ON THE SYSTEM,
RATHER THAN ON EXTENSIVE SUBSTANTIVE TESTING. THE
INTERNAL AUDIT STAFF CAN ALSO DIRECTLY ASSIST THE
EXAMINING ACCOUNTANT IN MANY PHASES OF HIS WORK. THIS
IS OFTEN TO EVERYONE'S BENEFIT, BECAUSE THE INTERNAL
AUDITOR'S KNOWLEDGE OF THE COMPANY GENERALLY PERMITS

HIM TO PERFORM MANY TASKS FAR MORE EFFICIENTLY AND EFFECTIVELY THAN COULD AN OUTSIDER.

I KNOW THAT MANY IN YOUR PROFESSION HAVE BEEN TROUBLED BY THE CAUTIOUS APPROACH DEMANDED BY THE AUTHORITATIVE LITERATURE OF THE PUBLIC ACCOUNTING PROFESSION IN RELYING ON THE WORK OF INTERNAL AUDITORS. UNFORTUNATELY, SUCH LITERATURE MUST OFTEN BE DRAFTED IN SUCH A WAY AS TO TAKE ACCOUNT OF THE LOWEST COMMON DENOMINATOR. I AM CONFIDENT THAT THE ENHANCED PROFESSIONALISM WHICH YOU HAVE BEEN SUCCESSFULLY SEEKING WILL HELP INSURE THAT YOUR WORK IS INCREASINGLY VALUABLE TO THAT OF YOUR FELLOW PROFESSIONALS IN THE PUBLIC ACCOUNTING SECTOR.

CONCLUSION

BEFORE CONCLUDING, I WOULD LIKE TO INVITE YOU TO SEND ME YOUR COMMENTS ON ANYTHING I HAVE SAID, OR ON

ANY OTHER ISSUE BEARING ON INTERNAL AUDITING. I
HAVE FOUND THAT THE LETTERS I RECEIVE OFTEN CONTAIN
THOUGHTFUL INSIGHTS INTO MATTERS WHICH I HAVE
PUBLICLY RAISED, AND I WISH I RECEIVED MORE OF THEM.
SO PLEASE FEEL FREE TO SEND ME YOUR THOUGHTS.

THE INTERNAL AUDITING PROFESSION HAS, I BELIEVE,
A BRIGHT FUTURE IN PROVIDING SERVICE TO AUDIT COMMITTEES,
CORPORATE MANAGEMENT, AND THE OUTSIDE AUDITORS. ALL
OF THESE FUNCTIONS ARE IMPORTANT AND ALL ARE SUPPORTIVE
OF THE KEY CONCEPTS OF CORPORATE ACCOUNTABILITY AND
PUBLIC CONFIDENCE. THOSE KEY CONCEPTS CANNOT BE
OVEREMPHASIZED. I BELIEVE THAT THE ON-GOING VIABILITY
OF THE CAPITAL MARKETS, WHICH HAVE SUPPORTED OUR FREE
ENTERPRISE SYSTEM FOR SO LONG, IS IN LARGE PART DEPENDENT
ON THE CREDIBILITY OF CORPORATIONS AND THEIR MANAGERMENTS

WITH THE INVESTING PUBLIC. INVESTORS MUST BE PERSUADED THAT THE COMPANIES IN WHICH THEY ARE BEING ASKED TO INVEST THEIR MONEY ARE INDEED ACCOUNTABLE TO THE VARIOUS SEGMENTS OF THE PUBLIC WHICH THEY PURPORT TO SERVE. AN IMPORTANT PREREQUISITE TO THAT ACCOUNTABILITY IS THE AVAILABILITY OF COMPLETE AND ACCURATE INFORMATION TO CORPORATE MANAGEMENT AND THE BOARD OF DIRECTORS.

THE INTERNAL AUDITOR IS THE GUARDIAN OF THE INTEGRITY OF THE CORPORATE INFORMATION SYSTEM. TO PROPERLY FULFILL THIS ROLE, YOU MUST CONTINUE TO ENHANCE YOUR PROFESSIONALISM AND TO TAKE A GROWING INTEREST IN DEFINING YOUR OWN FUNCTION IN THE CORPORATE PROCESS. I AM GLAD TO SEE THAT THIS PROCESS IS WELL UNDERWAY, AND I TRUST YOU WILL CONTINUE IN THE FUTURE TO MAKE SIGNIFICANT PROGRESS TOWARDS A CORPORATE SYSTEM IN WHICH INTERNAL AUDITING PLAYS A MAJOR PART.