An approach to internal auditing

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AN APPROACH TO INTERNAL AUDITING

BY

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In partial fulfillment of Degree Requirements for a Master of Science Degree in Business Administration at The University of Richmond, Richmond, Virginia.

May, 1961.
This work was initiated as the result of my interest in this subject, and of my sincere convictions concerning the importance of internal auditing. This is internal auditing as it should be.

When an employee is placed in such a unique position of trust that an auditor occupies he is indeed privileged. I have occupied that position, and was further privileged to have been under the supervision of a very great and dedicated chief auditor. Until the time of his retirement, one year ago, he patiently imparted as much of his knowledge of our subject as was possible for him to do. There are few such instances in a lifetime in which one man can receive from another instruction and guidance that comes from the devotion and complete dedication to a job. What I have written is my understanding and interpretation of that dedication.

I dedicate this book to the man who was the conscience of our company for thirty-two years --- Mr. Frank E. Bragg, former Traveling Auditor of The Chesapeake and Potomac Telephone Company of Virginia.

M. W. J.
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Purpose

It shall be the purpose of this study to examine internal auditing as it applies to today's large corporation so that those who will enter this field may know what it is, and that those who are already in it may possibly be influenced by one of their fellow auditors, to the end that this work may be made more useful, more effective, and better understood.

Role of the Internal Auditor

Perhaps in all of a corporation’s internal affairs the role of the internal auditor is most unique, for he stands alone. Others in the business have specific assignments: schedules to meet, production indices to conform to, or some function related either directly or indirectly to the accomplishment of the company’s reason for being. The auditor does none of these, yet he is very much a part of all of them. Indeed, it has been said that he is the conscience of the company.

In point of fact, he is usually a staff member, separate and distinct from line functions; and he fulfills his assignment by carrying out a schedule of internal audits on:

(a) records of company data

(b) inventories and supplies

(c) the handling of company funds
(d) the extent and quality of supervision

(e) quality of internal controls

In carrying out this assignment he will reach all areas of the business, and will have crossed over departmental lines many times. To him all doors are open, and he has management's attentive ear. This is truly a great responsibility -- but it can also be greatly rewarding, for in few other assignments in a large, modern corporation can a man see the results of his efforts go into effect so quickly. Yet, with all of his independence -- his unique status in the business--he is totally and completely dependent on others. Without them he could not function, for they do the work and perform the duties that he will audit and report on to higher management. They also will be the ones to answer his questions (if he has won them over they will volunteer the information).

Here, then, is the description of a very real man, who exists somewhere at the level of middle, or even higher, corporate management. How he performs his duties; his effectiveness; to whom he reports; his personal experience; and his ability are only some of the areas which must now be examined if we are to have a clear understanding of internal auditing.

Definition of Internal Auditing

Basically, and very broadly, internal auditing is a management tool. It is used like any other tool as a means to an end: the end is not accomplished with the audit alone, this only shows the way, or gives direction to
the thoughts and questions that will arise after an audit has been completed. Therefore, it can be said that the work of the internal auditor provides the information -- the tool -- for higher management to use in carrying out its policies concerning the conduct of the business. It is a report of conditions as they existed, in a certain part of the business, as of a certain time.

Of equal importance to the definition of internal auditing, is a definition of what it is not. Specifically and emphatically, it is not a detective job created for the purpose of spying on employees, or presuming their errors to be immediate indications of dishonesty, theft, or any other form of misuse of company property. When differences occur the auditor must first regard them as just that: differences, but he may have reservations. To accuse; to imply that an accusation is made, or to create an atmosphere that makes the employee involved with the difference feel that he is suspected of wrong-doing is not only wrong; it is out of place, and presumptuous. This must come as a conclusion, and as such, is used only after much examination and soul-searching; but never at the outset.

It would indeed be ideal if we could feel that this type of auditor did not exist in our large and important corporations today, but unfortunately some few still do. However, he is as anachronous as the company spy of yesteryear, and as pathetic. Perhaps with more and more emphasis and attention being brought upon the internal auditing activities of the company, this type will be weeded out, for his strong point (that he is management's chief spy) will prove
to reveal his weakness, and he will not be able to perform as a member of the company team, wherein the basic requirement calls for intelligence, skill, and finesse.

Further, on the positive side, internal auditing is an area of control. The auditor, along with everyone else, is charged with certain responsibilities. How these responsibilities are being met comes within the purview of the auditor, but the fact that they exist is of primary importance. By way of review, then, let us first see what has been created as a business entity.

Management creates a business venture, which with careful nurturing, skill, and some good fortune can result in a large corporation, such as those we see today. As this growth process continues, the original responsibilities do not change -- they remain the same -- as do the objectives. However, change begins to occur as size and volume increase, in that control of responsibility begins to decrease for any one individual. What was originally handled very ably by one man may now be handled by a district, or a division, or even a company area. Hence, direct control is passed from one individual to many, and various levels of supervision have been created to carry out the original objectives. Added to these levels of supervision is the internal auditor, for he is, as they are, directly concerned with the internal controls which are established to accomplish the stated objectives. These will include:

1. supplying the company's services or products at the lowest possible price consistent with the desired quality.
2. fair treatment of employees; to include adequate remuneration, pleasant environment to accomplish their tasks, and an opportunity to achieve their maximum potentials.

3. Adequate protection of the investment of the owners of the business, and to provide them with a reasonable return on their invested capital.

With the statement of the objectives, there must then be a proper organization to carry them out. Such organization will accomplish the establishment of responsibility at specific locations, and provide the vehicle by which the coordination of effort can be directed toward the common goal: the successful conduct of the business. This, then, is the framework of objectives and organization, within which the auditor is to fulfill his assignments, and make reports of his findings to those who are required to know them.

Varied Nature of Auditing

In describing the varied activities which are included in auditing, reference is made to the juggler who keeps "three balls in the air simultaneously." Auditing activities in a large corporation at times are equally as varied. While the auditor may be examining certain accounting records, his attention can be diverted to an inventory shortage; meanwhile some pet theory he may have had about still another weak condition in this business may reach a dangerous point, and he is required to give attention to that also. Indeed, this work is for the agile employee, one who can make decisions quickly and when under pressure;
one who can drop one job when he is right in the middle of it -- and begin
an entirely different one; and it requires a person who can leave his home
and family frequently and sometimes with little advance notice, for he must
make the rounds of the company's offices as he performs his tasks.
CHAPTER 2

BACKGROUND OF INTERNAL AUDITING: ITS MISSION

In the foregoing chapter the attempt was primarily to establish the auditor within his company, and to give a broad view of his area of operations. Virtually, he can operate anywhere, for the service he can render daily is almost without limit. When he is understood, and has cultivated the faith and trust of other employees he can become a fountainhead of knowledge.

What Management Expects from Internal Auditing

By showing previously that the size and pace of modern business have increased so tremendously that direct control over one individual's entire area of responsibility is no longer possible or practical, we see that sectors are thereby created in which no real supervision or control exists. In each department of the company many such sectors will occur. Individually, and collectively, (they are often related) their effect becomes compounded, since no control between departments is provided. To meet this inherent weakness the auditor was created, and he can fill the gaps in these loosely supervised areas of responsibility.

Since the end of World War II there has been a gradual, but steady change in executive thinking with regard to company reports. Previously, the balance sheet was a key document from which many decisions were made and important conclusions drawn. This has given way to today's executive's
need to know more about the business he is administering. The balance sheet presents too restrictive a view of what is happening, so other means had to be found which would provide more information, in greater detail.

The senior executives, or managers, have now turned their attention to many more detailed accounting reports to obtain a view of the administration of the business through the accounting system. To provide a greater degree of accuracy to these reports than can be accomplished by the normal amount of supervision given to accounting transactions that find their way into account balances, management relies on the internal auditor. In the usual course of his operations he will reconcile the balances of all major accounts, but equally importantly, he will have done sufficient field work at the company's many outlying locations to have seen enough of the daily transactions to satisfy himself that the methods being followed in making charges and credits to the accounts are the prescribed ones. Here, again, the element of control is manifest, for the auditor is doing what higher management cannot do, and he is advising them of his findings.

Further, management wants to know that the integrity of its cash and assets is intact. Management has stated quite candidly that it is not in business to catch thieves. This is very easy to accept, for there is too much invested in each employee in the company after he has been there for any length of time, to relish the thought of having to dismiss him, and perhaps see him prosecuted because he took company funds. In addition, it makes very bad
publicity when the huge corporation appears in the newspapers as the legal antagonist of the lowly worker. But equally important, is the fact that management failed to keep its control and system of safeguards intact so that the employee would not have been a victim of temptation in the first place. This is perhaps one of the most important responsibilities of the internal auditor, and it is constantly demanded of him by management. He must make a constant and never-ending examination of the safeguards and internal checks that exist, and continually strive to improve upon them, with the thought in mind that a good system of safeguards will deter many employees from taking the risk that usually leads to him being found out.

The Need for Internal Control Above and Beyond That Afforded by Immediate Supervision

Thus far it has been shown that there are areas of activity within the corporation that often go with little or no supervision. To cite a few: (1) isolated or remote locations under the care of a tried-and-trusted old-timer, (2) important sections that contribute to the over-all job of the corporation, but are not given much direct supervision because they have a reputation of always doing a good job, (3) reimbursement of personal expenditures without a properly approved document to show that the reimbursement is proper, and (4) use of company property, e.g., automobiles, without proper authorization. These are but a few, but they serve the purpose of showing that an auditor would have a field-day with any one of them. Also, they show that the system
of internal controls is not working -- it has broken down if these conditions exist, for anyone cognizant of business in general can see that these conditions cannot continue to exist if the business is to be run effectively. However, at this point we are considering that these are activities which exist and occur daily; they aren't supervised simply because no one can get around to doing it.

In the order of probable sequence, here is what can and might happen:

(1) The tried and trusted old-timer will begin selling the company's junk (and new) material for his own profit. He will make contracts or agreements with outside suppliers, who will reward him for his favoritism to them. (2) The reputable section, depending on the department in which it is located, may begin altering book entries to agree with distorted facts. This can be shown very simply in the case of stolen inventory and property records adjusted to agree with the theft. (3) Sooner or later, a falsified voucher for reimbursement of personal funds purporting to have been spent in the company's behalf will run into difficulty. Perhaps it was shown as meals for out-of-town visitors, or the purchase of an item of equipment, or for traveling expenses. The initial success at this sort of manipulation only serves to make the doer try for bigger stakes; and that usually leads to detection. (4) Using company property without authorization can be shown quickly in the case of the employee who takes a company automobile home after working hours, in spite of the fact that he knows this to be against company regulations. Even a slight traffic involvement would bring this escapade to a sudden end.
Admittedly, an army of internal auditors cannot stop all of these activities, but a good, effective auditing team can curtail them to the point where the loss isn’t serious, and most of the employees are conducting themselves honestly. How would the auditors accomplish this? Simple, by taking the trouble to visit these remote locations; by visiting the section that isn’t supervised very often; by examining personal expense vouchers, and learning why the claims were made (this can be done quite readily by showing the voucher to the supervisor of the one who prepared it); by visiting company garages and parking lots to check on the location of various automobiles. In addition, the auditors should make it known that these formerly unsupervised locations will now be subject to continuing observation, at unannounced intervals in the future. This is guaranteed to shut the door on promiscuous and flagrant abuse and theft of company property. However, as a word of caution, the looseness and abuses will return unless the program of continued examination is maintained, and existing checks, cross-checks, and safeguards are strengthened and improved with the passage of time. It has been learned from experience that some of the company’s best methods of control are worthless when a new system is adopted, or when new methods of doing the job are introduced.
CHAPTER 3

THE AUDIT

In this chapter the typical audit will be described as it actually occurs in different situations and locations. The description is intended to be sufficiently broad so that the methods employed, which have been used effectively in one type of business, can be used by others in their businesses.

What the Auditor Must Accomplish

When the auditor arrives at an office of the company to conduct an audit, he is at once many things. Most importantly, at this moment, he is the representative of the department head who is responsible for the office or other location about to be audited. With this fact in mind he is received in that office. His mission will be to examine, to the best of his ability, the condition of the office, and to make his report to the department head.

The arrival of the auditor years ago was generally the signal for mass nervousness and for feelings of personal guilt to start. Unfortunately, some of this nervousness still begins when the auditor arrives, but it is hoped that it is far less today than it was in the past. It is only natural that each employee will experience some uneasiness when he knows that the performance of his job is about to be evaluated, and a close examination of his records will be made. Regrettably, this identity has been attributed to the auditor, and many of them have encouraged and abetted others in creating this myth. However, it is only a myth, for the auditor is in truth, a fellow-employee. (It will be shown later
that some use can be made of this natural uneasiness which many employees experience when an auditor is making an examination, but it is the exception, not the rule.)

In accomplishing his mission, the auditor brings with him an abundance of knowledge and experience which he can impart to the employees in the office he is auditing. By the very nature of his work:

1. He has read the instructions pertaining to their department, and knows what they are required to be doing.
2. He has made audits of similar offices within the company and has seen how others are carrying out the same instructions.
3. He knows what the end result of the efforts of this office will be, even if the employees do not.
4. He knows how this office is related to all others within the company, and of the importance that it must fulfill its requirements in the accomplishment of the company's reason for being.

Sincerity of the Auditor

As it is in most things, sincerity also applies in auditing. By exerting every effort to convince other employees of the company that he not only wants to audit their work, but that he also has a sincere desire to help them, the auditor can realize a much greater gain than he would if the former, more severe roll of self-appointed judge and jury were permitted to prevail. Experience has shown that people will reveal their misunderstandings and errors in
their work to the auditor, if they are able to feel that these revelations will not become immediate notations on the auditor's pad, to be amplified and criticized later on as items in his official report to management.

When such a relationship of mutual trust and respect has been established between the auditor and the employees throughout the company, he can then feel with rightful pride that he is doing those things that are required of him, and he has proven worthy of the trust placed in him. In addition, he will be rewarded by having employees at all levels of the business reveal weaknesses in their organizations to him, knowing that his treatment of them can often produce greater results than their own remedial efforts. Truly, this is real auditing, as it should be. It is not idealistic, for in any large corporation today, if a close look were taken at its auditing staff, one would find those who are trusted and helped by their fellow-employees when an audit is being made; and those who are only helped when they ask for certain records or information -- and it is only done on a very formal basis, in the line of duty. Little or nothing is volunteered as aid or assistance to the latter type, and he is the loser, for he will have to dig deeply for everything he obtains.

Quite naturally, some of the information which is voluntarily furnished to the auditor by employees will be items which he will have to include in his report. However, here is his opportunity to show his appreciation for the manner in which he first learned of the situation. If the auditor is realistic he knows that employees can hide or suppress certain records or data that the average
auditor, making the average audit, may or may not detect. His audit certainly will not include an examination of everything in the office—time and good judgment preclude this. Therefore, when he is given information of value, and which is directly related to his audit, his handling of the information is of particular importance. He must now weigh in his own mind the best way to convince the employee that this information is sufficiently important so that it should be reported, and yet not lose the confidence of the employee by appearing to have violated a personal trust. This is truly the case for discretion and finesse.

Conducting an Audit

When the auditor arrives at an office to make his audit, his first obligation is to the local manager, or other employee who is in charge of that particular location. After stating the purpose of his visit, and his statement as to what he plans to accomplish, he is ready to begin work. The following description of how he works and the sequence of his course of examination can be applied to a bank; an office where bills are paid to a company, such as a utility company; business office; or to a retail establishment belonging to a chain organization.

Examination of Cash Collections in the Hands of Cashier

The first and foremost item of importance is an examination of cash. This must be done immediately, because cash in the hands of a teller, cashier,
or clerk can be manipulated and an existing shortage can be restored while the auditor is talking to the manager. After all, one piece of money looks exactly like any other, and the money in a teller's purse, which may have been taken previously, can be put back quickly, and a weak situation may go undetected. Therefore, it is essential to count the cash on hand first.

At this point an interesting development often takes place, which is definitely worthy of mention. When an auditor begins to count a teller's or cashier's funds on hand in order that he might balance them against some bill stubs or other records on hand, many tellers will walk away to do some other work while the auditor is left with all the money for which the teller is responsible. When this happens the auditor should discontinue his counting and cease all contact with the money. This is important for two reasons. The first: the auditor could steal some of the money himself and blame the shortage on the teller. This is not very likely, for he would be under suspicion the next time it occurred. However, it serves to point out the fact that a resultant shortage would provide two suspects, each pointing guilt at the other, instead of the auditor maintaining his impeccable position. The second: the teller could give her funds to the auditor for him to balance, knowing that there is a shortage which she created, and then blame the auditor when he confronts her with it, by holding to the position that her funds were in balance before the auditor touched them. This can be awkward and frustrating, for management would be confronted with two of their employees -- each protesting
his innocence -- yet, someone is guilty. This weakness can be eliminated by demanding that the teller, fundholder, or any other employee who normally handles company funds, and who is charged with the responsibility for those funds, always be present to watch the auditor as he counts the money, and sees that his balance is exactly as hers is.

Examination of Records of Money

Records of money are generally as valuable as money. If one controls the former, he can often control the latter. It is for this reason that wise management will divorce these two functions from each other. The clerk who receives the customer's payment, and who also maintains the record of customer payments could be the source of great internal weakness.

After examining cash, then, the auditor will proceed to records of cash. This will include current cash records -- usually directly related to the cash he has just counted -- such as, bill stubs or receipts, pending transactions, which make up outstanding billing to the customers, and are known as accounts receivable, due from customers, or some other similar designation. Finally, he will examine written-off, or uncollectible accounts, because they too represent cash.

Current Cash Records

There is a definite relationship between the cash at a teller's location, at any period of time, and her stamped or receipted bill stubs: cash on hand less her beginning petty cash advance (to make change) equals the total of the bill stubs. In the examination of bill stubs care must be taken to insure that
cash and bill stubs are both for the same payments. Companies often give their tellers "paid" stamps to use in stamping the customer's and the company's portion of the bill. These stamps should have a provision for showing the date on which the payment was made. It is here that an employee could alter a record of payment, and take cash that has been entrusted to her, by means of a method known as "kiting." Very briefly, kiting is a means of stealing money today and putting back an equal amount tomorrow, but the amount being replaced comes from another customer's payment, and his bill stub is set aside, while the first bill stub is reinserted along with other current stubs to go on through the billing operations. Banks are familiar with this practice in those cases in which a person will write checks on many banks in quick succession, covering his activities by having an initial account in only one of the banks, and always managing to make his moves faster than the checks can go through the clearing house and back to the bank on which the check was drawn.

Since most businesses bill their customers on some regular cycle; generally monthly, the overly alert teller will notice that there is a delay between the time that payment is made and the time for next month's bill or statement to be prepared. In all of the company only two people know whether or not the customer paid the bill; these two are the teller and the customer. By kiting funds, the teller will take funds today and use other payments to replace them tomorrow.

*Kiting is used here to include "lapping" because the former term is used to describe both conditions in internal auditing usage.
However, it is a scheme doomed to failure, for as the amount being withheld becomes larger and larger, so must tomorrow's payments, which must cover all of the withheld bill stubs. It is then that detection occurs, and management realizes that its system of safeguards wasn't entirely effective after all.

Another loose condition that can lead to an employee's taking money, and abusing her position as a trusted employee, is to accept payments from customers, giving them a stamped bill stub for their record, but she could be using the "paid" stamp which is marked with the identification of another teller. When this happens, she could pocket the money, destroy the company's portion of the paid bill, and sit back and watch the guiltless employee receive the blame when the customer produces a paid bill stub with the innocent teller's stamp on it. Let it suffice to say that "paid" stamps also have the value of money, and should be handled as carefully. When they are not being used by their rightful owner, they should be securely locked up.

Records of Deposits

The auditor must assure himself that each office in the company handling company funds is depositing those funds on a regular basis, as stated in company instructions. This will usually be on a daily basis, and an examination of the frequency of deposits and amounts will tell a great deal at a glance. Anyone as familiar with his own company as an auditor is, should know that there is a certain regularity of receipts into the business each day. Thus, over a period these can be averaged, and that average should be quite stable. This will be an aid in telling the auditor
if all of the funds are being deposited, or if along with other clues he might have, someone is withholding some of the money and is using it for his own purposes for a few days before making the deposit. It should be quite apparent to anyone with a little imagination that the use of someone else's funds to finance a personal venture for a few days can be quite tempting to many of us.

**General Rules for the Control of Cash**

Since cash represents the one item of greatest attraction to the employee who is willing to obtain it dishonestly, it requires the greatest protection from the standpoint of company internal security. To accomplish this security the following requirements are provided as fundamental rules to be used in any office which regularly receives payments from customers:

1. That proper control records are maintained.

2. That deposits are made daily, or on some regularly scheduled basis.

3. That records of deposits are reported to the accounting department promptly. (Even better control can be obtained if a separate report of each deposit is also made to the accounting department from the bank.)

4. That proper storage of collections prior to deposit is maintained.

5. That records of individual teller's overages and shortages are maintained.

6. That the combination to the office safe is changed whenever an employee who knows the combination no longer works in that office.
7 That the combination to the office safe be restricted.

8. That more than one person is present whenever the safe is opened.

Records of Accounts Receivable

One of the largest single items, at any one time, and an item of great value to the company is its accounts receivable, or known by another name, "due from customers." In companies that have centralized accounting centers, which render bills over large areas, and keep master records of customers' account balances for their local branches, the auditor can know a great deal about the type of job the local office is doing before he actually arrives there. From the master records he can examine those accounts which are handled by the local office in question, and determine if the office is making collections regularly, or if it is permitting account balances to become older and larger, so that the ratio of outstanding billing to current collections has gotten dangerously high. The auditor can also examine those accounts which have been sent in by the local office as being uncollectible, with the view toward assuring himself that proper treatment and supervision have been given to these accounts. Later on, when he is conducting the audit of the local office, the auditor will be able to assist himself by referring to those records he obtained from the master account records. Needless to say, there must be agreement between the two sources, or in the event of disagreement, easily explained transactions must have occurred.

If billing and accounting are performed at a centralized location, the auditor is fortunate indeed if he takes advantage of the information which is available to him.
By their very nature, the two types of accounts -- current accounts, and written-off accounts -- are key factors in the financial health of the business. To know how these accounts are being handled before the auditor leaves his office not only assists him in planning how he will spend his time, but it gives direction to his audit once he arrives at the local office, by enabling him to have decided beforehand just how he will budget his time, and which other items he will look at that may or may not have been included in his original schedule of examination. This is a vital part of internal auditing, because many records are either examined in great or little detail, depending upon the results obtained from examining related records. Since the auditor's time is limited to some extent, he will pursue the areas of weakness and leave the areas of strength in the background once he has been able to establish which is which.

Inventory Records

Of equal importance with accounts receivable, is the company's inventory. This item runs into the millions of dollars in large corporations, and it is subject to many transactions, both in and out, and it can offer great attraction to some of the employees. Truly, controls over the inventory and inventory records have to be good. The simple fascination for a new piece of equipment by enough employees who permit themselves to take a sample home could lead to sizeable losses. This type of loss, and actual theft must be kept to a bare minimum. Therefore, our efforts to maintain good control must be constant.
Physical Inventory

At least annually, the company will conduct a physical inventory of major supplies. In addition to all the other responsible supervisors, the internal auditor should be present. It will be the duty of all of these supervisors to follow along as the actual physical count is made, to lend assistance where necessary by giving interpretation to instructions, and explaining the intent behind certain rulings. The emphasis is definitely on accuracy, for any questions which are raised after the inventory has been listed are either very difficult or impossible to answer.

A word of caution is directed to the auditor at this point; he must insure that all pertinent items have been counted, recorded, and included in the physical inventory. If certain items have been omitted from the listing intentionally, they might never be shown on the company's books, and they could be disposed of by some employee later on, to his financial advantage. Therefore, the auditor must plan to make roving visits to as many of the inventory locations as possible, making notes of significant items which he sees, asking questions about whether or not certain items have been taken up in the inventory, and checking these items later on when the lists have been forwarded to the accounting department for reconciliation.

Accounting Department Inventory Records

Since the inventory was made at the request of the accounting department, and under its instructions, the completed inventory forms are returned to that de-
partment. There, the actual field count will be totaled and compared with property records for the purpose of establishing -- as of a certain period -- the actual number of each item of equipment that is on hand. This will then become the basis for determining the number of each item on hand, and they will be priced out to determine the value that they represent. This is all necessary to provide answers to questions regarding how much is invested in the inventory for company administrative purposes, and for tax purposes.

The auditor's interest in the inventory is very great from an accounting standpoint. All records pertaining to the movement of items in stock come to the accounting department for handling. New shipments of stock items are added to the inventory, disbursements from stock are deducted. It is in the accounting department that the control of the inventory is maintained, and physical inventory counts are reconciled against accounting department balances, not conversely. Therefore, it is not difficult to imagine what can happen to the records if there is collusion between a man working with supplies, and a clerk who posts inventory records.

After the physical inventory has been summarized in the accounting department, differences between the balance in the field and on the books in the accounting department will be noted. Many of these can be explained and eliminated as having been caused by:

(a) Not taking into account supplies in transit, which had not been inventoried either at the shipping or receiving end within the company.
(b) Supplies at a company job location, remote from the supply center, and overlooked at the time the inventory was held.

(c) Supplies which had been returned to the manufacturer for credit for various reasons. Some will have been defective, others were incorrectly ordered, or incorrectly shipped, and the manufacturer will have to take them back and allow proper credit.

(d) Certain supplies which had been disbursed previously for a given purpose, then returned to the supply center when the purpose may have changed, and no notice of this change forwarded to the accounting department to make the proper entry in the property books.

All of these occurrences are normal in a business, especially when large volumes of transactions take place. However, the real test of the accuracy of inventory record-keeping comes about when the final statement of inventory differences is completed. Then it will be seen that some items in stock are greater than the book record shows. These will have to be written on the record. Others will show less than the book record. This difference will have to be written off. Obviously, this can be a great source of concern to management, for large sums of money are involved, and the control over the inventory of supplies is not what it should be. It is, therefore, essential that the auditor maintain a close and intimate knowledge of transactions involving supplies, both in the field and in the accounting office.

One final point concerning the control of company supplies, taken from the author's personal experience, may prove of value in citing the need for control
and an understanding by all employees of the importance behind company regulations.

While riding on a local bus some time ago, the author noticed another passenger, who had a box of a particular company's leading product plainly visible on his lap. Neither the author nor the other passenger knew the other. Since the time was after normal working hours, it was unlikely that the man was carrying the package for business purposes, so a casual conversation was begun, which soon got around to the prominent package. The other man spoke quite proudly about it, saying that it was his company's newest model, and that he was taking it home to try it out. He stated that one of these should be in his home because he felt that the company wanted him to have the latest model so that his friends would see it in use and be influenced into purchasing some for themselves. This one item costs the company $25.

How such misconstrued interpretations come about is difficult to explain. Of course, there are those employees who develop the attitude early in their employment, that the company is their protector and their supplier of every want; as the company fares, so do they fare. Basically, many of these employees mean to do no wrong, but their actions can be wrong for the company, and the auditor must increase his efforts to make certain that the reasons behind company policies and regulations are made clear.

The Auditor's Feel for the Job

After having served in a particular company as an auditor for a period of several years, and having made the rounds of all of its departments and outlying
locations on audit assignments, many men in this capacity claim that they can predict with a high degree of accuracy, the way in which the audit will turn out. We describe it as a "feel" for the office or department, and it is by no means a form of magic. This author has seen it develop within himself, and quite happily, it has been generally very accurate.

An examination of the facts at hand should explain the reasons why an auditor will declare to himself before he has even left for his audit destination how he thinks the audit will turn out: excellent, good, fair, or poor.

1. He has audited this office before, and has learned those areas in which its employees are generally weak. He has worked with them on these weaknesses, and has cited some of them in his official reports.

2. He knows the caliber of the local manager, and has seen his reaction to constructive criticism in the past. When a departure from instructions was disclosed, or when a weakness resulting in loss of control was pointed out, the auditor noted the reaction.

3. He has seen the level of morale in this office; whether or not the clerks take pride in their work, if they are trying to hold their office and their supervisor up as a leading office in their company. Or whether they only regard their work as a job, to be done with as little effort as possible.
4. He has seen the relationship between the manager and the district manager. Do they work well together? Does the district manager set unattainable goals for the manager, and fail to appreciate or understand his position? Or does the district manager try to help the local manager, realizing that the more successful the local manager, the better his own position will be.

5. He has seen the department heads in their relationship with their own employees, and with the employees in other departments. Do they back up and support their own employees? Do they have a staff organization to look into methods and results within their own departments? What has been the reaction to former audit reports submitted to these responsible members of management?

Certainly this is not magic. It is experience. However, it is experience that comes about only by going out and actually making the audits, and observing the people involved, and learning the true natures and the problems of the other employees in the company. There is no other way to develop this "feel" for auditing work; it won't come by sitting in the office and reading about it, but then, neither will the ability to become an auditor.

**Use of a Ruse in Auditing**

Occasionally, the auditor may find it to his advantage in accomplishing his objective by resorting to a ruse to cause employees to think he is making a
more detailed examination than he really is. A simple illustration should make this quite clear. Suppose an auditor has been in a particular area of the company conducting an audit, and after he has finished there is still some time left over before he has to leave for some other destination. In this same area is another company office which performs a different function, and which has not been audited in quite some time. By going into this office and making a cursory examination of a number of their records, not paying particular attention to anything specific, but everything in general, the auditor can accomplish quite a lot.

Admittedly, this approach may appear to belie the claim that the auditor is aware of the employees' uneasiness when he is in the office, and that he always works to dispel their fears. This approach does not violate that statement, it only puts to good use a naturally created situation. In general, most clerks are ignorant of what an auditor does in detail. They know that he looks at their records, but they know little about what he does or thinks after that. Therefore, by capitalizing on their innocent ignorance, he can let himself be seen going over their records, when he is really doing very little at all. Here he has put some free time to good use at a location, which would not have been visited until perhaps much later on, but most importantly, he has shown himself, going over the records, and made a very important contribution: the employees now know that he can appear unexpectedly at any time, and he is interested in their records. It follows that they could be motivated in a very salutary manner as a result.
Without attempting to sound like an alarmist, it shall nevertheless be necessary for the author to cite cases from his own experience in which trusted employees have been temporarily successful in their efforts to convert company property to their own use. In some cases success lasted for years before detection occurred. In others, for one reason or another, detection was swift. In all of them, however, the results are about the same: there is a loss of an employee, possible prosecution with resultant imprisonment, shame and hardship brought against his family because of his underhanded activities -- even though he may simply be trying to provide them with a greater collection of material possessions.

Certainly management has a share of his guilt. If the employee had not worked in our company he would not have been guilty of committing those same thefts. A reasonable man could agree with this. Simply because the internal auditor was able to detect the theft or other wrongdoing, and set a trap into which this hapless person finally became entangled, is no cause for joy by the auditor. In fact, it is cause for sadness. A man is now marked for life, and we -- all of management -- had a share of his crime; we just were not successful in making him resist temptation. Here is management's burden.
The Association of Internal Auditors

Over the years internal auditing has grown into a highly specialized field, which now has its own associations, The Institute of Internal Auditors, being a very well-known one. In these associations auditors from all types of businesses and industries air their problems, and submit reports on cases which have occurred to their knowledge, so that other auditors may use the cases for whatever value they may have to them. In other words, they trade information in these associations, and strive to make this type of work more effective, and to improve their own standards. Since these journals of reports receive wide distribution -- does it not follow that the would-be company thief is gambling against overwhelming odds when he embarks on a career of theft and misrepresentation? Perhaps some true cases will illustrate the point.

Cases of Theft and Defalcation

1. A very recent case involved a foreman who submitted for reimbursement, a voucher to a fundholder of the company, for expenses incurred in connection with a trip of one week's duration, on company business to a distant city which he allegedly made. These matters are generally routine; foremen are often sent off on such trips, so this one should not have been unusual. It was unusual though, because the fundholder and the foreman's supervisor usually worked very closely in these matters. It had been their agreement that he would tell her when he sent his men away on trips, so that she could
obtain additional funds for her rather limited advance account, to meet these expenses. Since the foreman's supervisor had not contacted her with regard to this foreman's trip, she contacted him. The result was quick, the trip had never been made, and the foreman was fired; thereby wasting twenty-one years of service, with all of its benefits and security, to obtain seventy-five dollars dishonestly.

2. In this case a trusted company teller was revealed to have taken $3,000 of the company's money over the short period of about eight months. As it happened, she had previously worked at the branch bank in which the company's office made its daily deposits. At the bank she was familiar with her future employer's manner of making his deposits, and also the average amount of those deposits. When she applied for employment at the company in question, her former work and reputation at the bank were checked, and appeared to be very good. Since she had handled money in a bank, her new employer assumed that she would do well handling his money. This is a fair assumption, for past employment at a bank is usually a very good reference.

The type of theft employed involved kiting -- she took customers' payments and the related bill stubs today, and replaced today's bill stubs with ones for a like amount tomorrow, but still holding the money, floating like a kite, as the amount grew larger and larger in keeping with her new station in life. Finally, the amount withheld amounted to $3,000, and she was in
trouble. Since she also prepared the daily deposit she thought she saw a way to shift the blame. In preparing the deposit slip she made it for an amount equal to $3,000 more than the amount of cash in the deposit bag. (It is embarrassing for an auditor to have to admit that this ruse was not detected by her supervisor, or the first teller who handled it at the bank.) When the bank found a $3,000 shortage later in the day there was an immediate investigation. By process of elimination the known depositors of funds of that magnitude were quietly notified, and the investigative processes began.

After having been notified that his company might be involved in a large shortage, the internal auditor in this company was able to locate and associate the thefts with the teller in just three days. But in those three days there was much checking and running down blind alleys, and having to start all over again. During his entire search for the guilty person, the auditor kept saying over and over to himself, "please, let it be one of the bank's employees, not one of ours." Finally, it was evident that it was a company employee who was guilty, and the rest was easy. Upon admission of her guilt, the girl stated that she had used the money to buy a car for her boy friend, in order to keep him interested in her.

3. Here is a case in which two stockroom clerks in a manufacturing firm colluded for the purpose of selling pigs of metal to an outsider for their own profit. Both employees had about twelve years of service with their company.
Their guilt was detected after they had charged a particular branch of another company with these stolen pigs, along with other items in each shipment to them. When the foreman at the receiving company noticed the amount and cost of this item he immediately became suspicious, because he did not use this metal in such large quantities. He contacted his company's internal auditor, who, with the manufacturer's auditor, hid themselves in the plant and saw the thefts take place. This case was given to the local police because it involved outside interests.

4. In still another instance, an employee of a large vending machine company was apprehended for robbing the machines of a considerable sum of money. His scheme involved gaining access to the coin box inside the machine on the pretext of working on the machine. Since records are kept on the revenues obtained at each location, it did not take long to show that some of the better locations had taken a turn for the worse. The first test of the reason for the drop that the internal auditor made was to deposit marked coins in several of the machines in question. When these coins failed to show up when regular collections were made, it was obvious that someone had gained access to the coin box. The next step involved the services of a private investigating firm, which placed the machines under constant surveillance. The thief was apprehended, arrested, convicted, and sentenced to serve a term of imprisonment.

It is not unique that one auditor can cite case after case in which employees have attempted to "beat the system," and have subsequently been caught. We all
know of cases. Perhaps some employees first try their hand at crime in the spirit of a challenge: "a rule is only made to be broken, therefore, I'll prove that I can find a way to break it and not get caught at it." Foolish words, and a non-existent challenge. Yet it does serve as a challenge to the auditor to see that the employee does not succeed.

When these crimes are revealed management must really look to itself for some of the answers and the guilt. What went wrong with our system? Didn't we make it clear enough that these practices were illegal and would not be tolerated? Are we paying our people enough to provide them with the needs of their station in life -- in keeping with their services to us? Is our system of controls, and safeguards against employee thefts breaking down? The auditor knows the answers to these questions, because he is responsible for seeing that they do not occur; and this he shares with all of management.

Employee Awareness of the Internal Auditor's Activities

One of our largest and greatest corporations -- in terms of area of operation -- makes it a practice of requiring that each employee be made fully aware of the existence of the internal auditor, and the general nature of his work. Employees are told that the auditor will appear from time to time to look at their work, and to check on its accuracy. By telling employees that the auditor will check up on their work, it is hoped that this will discourage an employee from giving in to temptation. In other words, we tell him repeatedly that he is being checked and watched; he must not risk everything that he has at stake by gambling with doubtful
success at stealing. Whether it is attributable to good fortune, careful selection of applicants for employment, or because of this frankness with employees, the number of known cases of theft or other abuses of a position of trust have been remarkably few in this company.

**Relationship between Internal Auditors and Public Auditors**

At least annually the public accountants will make their appearance at the company. How closely they, and the company's internal auditing staff work together can be of importance to the successful efforts of each. By cooperating, they can avoid some unnecessary duplication, and each can furnish to the other information of a type which the other could not obtain. Together they can represent a very formidable challenge to employee wrong-doers.

Between the internal auditors and the public accountants there must be harmony. Although the public accountants' firm must sign the statement of condition which appears in the annual report to the stockholders, their accountants cannot presume to dictate policy to the internal auditors. However, they can and do advise. Since public accountants do their work in all types of businesses -- banks, manufacturing concerns, utilities, industrial organizations, and many others -- they are in an excellent position to see different types of controls at work, and to see the results when these controls are inadequate. Indeed, a conversation with one of them can be quite a revelation. Therefore, if we recognize that they are in a position to have a broader knowledge of our mutual subject, we can gain from them, as they gain from us.
During the course of the year the internal auditors can be doing the de-
tail work of examining account balances, investigating charges and credits to
accounts, examining deposits and withdrawals of company funds, watching the
inventory, lending accounting and other assistance where needed, and, in
general, do all those things which are expected of internal auditors. When the
public accountants arrive, these activities should be discussed openly, and the
data and reports should be produced and discussed. From these records the
public accountants can decide where they will place more or less emphasis of
their own. They can agree that in certain cases both groups will examine the
same item independently, e.g., cash, or the annual supplies inventory.

Decision of Company Audit Policy

It is not to infer that the company's audit staff should turn its authority
over to the public accountants, nor can it be expected that they will sit back
during the year and wait for the outsiders to do their work for them. Each group
needs the other. However, somewhere the policy as to what will be audited in
the coming year has to be established. Quite properly this decision belongs to
the company's chief internal auditor. Based on his instructions from his super-
visors, as he understands them, and on his judgment and experience, he will
decide what sort of audit program he will have. He can seek assistance from
the public accountants in making his decisions, and generally they will be very
glad to help him. They, too, know that he is the only one to decide upon such a
program, for his own knowledge of what is to be done can be far better than theirs.
Management Level of the Internal Auditor

An examination of different kinds of business would reveal that the internal auditors are located in high and in low places, and the proponents of each school of thought can support their choice concerning the relative importance of the auditor with very convincing arguments. If the reader would accept as a reasonable assumption the fact that no position in a business could continue to exist economically if it did not produce something of value to justify its existence, then it can be stated that auditors are located where senior management feels their true contribution is being made. In many instances not enough thought is given to the value of the auditor's contribution to the business, and he is merely regarded as a curious kind of staff employee. This kind of thinking can lead to a lowly status for the auditor, and very little contribution from him.

Conclusions

Throughout this chapter the intent has been to acquaint the reader with the auditor's position in the scheme of things, i.e., in the business organization, and how he resorts to the aids at his disposal in attempting to forestall employee theft. Some of this reading may have sounded harsh, as though the employee never had a chance when he once began his illegal activities. If that interpretation is taken, the point was well carried, for it was intended that way.
In calling this chapter, "The Challenge to Internal Auditing," the author has in mind the unending efforts of all of the management team to deter employees from taking company property or company funds. If they persist in spite of all the warnings, and the careful briefing on this subject, then the gauntlet is down -- and the auditor will pick it up. At the outset, the scales are tipped heavily in his favor, for in the first place, he has seen many of these same efforts tried in the past, and he knows how to detect them. Second, he is closely associated with the local police department, private investigators, and the Federal Bureau of Investigation. Third, he belongs to a type of association of experienced men who trade secrets about weaknesses in business and their control. Fourth, he has the assistance of other members of his company who regard theft and abuse with repugnance, and who do not want the "bad apple" to be identified with their company. Even today there is pride in company association; it works both as a deterrent and a detector where theft is concerned.

Management’s Views

On the other hand management sincerely does not want one of its employees to be involved in a theft. For the most part, American corporations pay good wages to their employees. Many factors influence this, and almost all of them are economic in nature. Management is not altruistic, it pays the going rate -- sometimes more, sometimes less -- but it wants to attract good employees who will leave company property where it belongs. Most assuredly the revelation of a theft is felt very keenly at the highest levels of management, for it is they who
must bear the disgrace and ridicule from outsiders, just as each employee in the business does. There can be a long enduring stigma attached to their company in the minds of the unforgiving, for the company in which the theft occurred can be maligned beyond all proportion - as being populated by other thieves, therefore, their product leaves something to be desired.

Internal Auditor's Views

We cannot afford to take our positions lightly in this work, for our responsibilities are very real and very great. So long as other employees are willing to abide by the stated rules of business there can be friendly relations based on mutual trust and respect. The auditor can then make manifest his desire to help, to interpret rulings, and to bring departments together when they differ in their views. Under these conditions he is performing the type of work which is the most satisfying in his assignment.

When the challenge is made he will reveal his other self and pursue with equal vigor, the task of tracking down the guilty employee and exposing him. It is indeed harsh, sometimes cruel, but always necessary. As an employee of the company, the auditor has an equal amount at stake in protecting its reputation, and in maintaining the right kind of relationship in the community.
CHAPTER 5

CONCLUSIONS

In the previous chapters several factors were considered. In the first place, the need for the internal auditor was developed and shown. This was done by taking the business entity which management had created and had taken as its personal responsibility, and by showing that the amount of supervision at any level in the business will, of necessity, be limited by other activities. This then, paved the way for the introduction of some other member of the management team who could gather up the loose ends of incomplete supervision and control, to weave a stronger framework of control for administrative purposes. These functions were assigned to the internal auditor, and he was identified as top management's alter ego in the examining and testing of the effectiveness of the company's administration and internal integrity.

Secondly, the auditor's work was examined in detail. It was shown that he can be in many places in quick succession as he pursues his investigations of the many company activities, which constitute his work. The wide and varied range of his assignments were also elaborated upon, with the view that this would give further insight into the type of man he must be, and of the extensive background and experience he must possess in order that he may be effective.

In the third place, a number of actual cases were cited in which employees had succumbed to temptation, and had ultimately been found out and treated accordingly. This was all part of the assignment of the internal auditor. If he was successful in deterring one employee from wrong-doing, he may not have been in another instance.
How Effective Was the Auditor

Reflecting back upon the description of the auditor, and the extent of his work, one cannot help wondering just how effective an internal auditor really was at the conclusion of each audit. It would appear to be perfectly valid to ask if he saw enough, and understood enough, in his relatively short visit to be able to draw an intelligent and realistic conclusion about his findings. Only to the extent of saying that auditors, just as any other employees do range from good to bad. Should it then be necessary to defend them as a group on a negative basis?

Rather, and very positively, can a case be made for the auditor's effectiveness. With experience, an auditor can know more about the details of an office than anyone else in the company. This includes the local manager and each of his clerks. Just as in sampling, wherein a sample can give a greater degree of accuracy about a given subject than can a complete count, due to better control being maintained over the sample than could be maintained over the entire universe, the auditor's tests can tell more than a daily contact with the records could tell. This carries the weight of logic because the auditor brings with him that which few others in the business possess: the underlying reasons why we must do the things which we do in our jobs. With this key factor in mind he is immediately armed with the device which gives significance to what might have been regarded by someone else as a very minor departure from an instruction, but which is to the auditor a major source of weakness because of its ultimate effect.
Actually, the auditor does rely on a sampling basis in the conduct of an audit, for each item of any major subject will not be examined in minute detail, item by item. Some items are examined minutely; cash is -- but the many ramifications of the complete handling of cash reveal that it would be impossible -- and unnecessary -- to follow this avenue to its end. Therefore, by wise usage of sampling techniques applied to all of the major areas of the office's activities the auditor can draw an accurate conclusion about the status and general situation of that office.

Findings and Recommendations

Of course, a true test of how effective the auditor really is or has been can be drawn to some extent from the reactions to his reports. In these, he has stated the impressions which the various offices have made upon him by citing specific instances in which errors of significance were noted, as well as other pertinent data which would have value both to higher management, and to the employees in the office under report. How responsible management reacts to these reports will indicate their faith in him, and their estimate of his real worth.

(At this point it would be well to digress for the purpose of acquainting the reader with conditions which can confront the auditor and make his efforts rather futile in certain areas.)

The auditor, along with every other member of management, is assigned on a certain level of management. This is done for administrative purposes and is akin to the system used in the army, in which levels of management are created
to range from second lieutenant to general. Quite naturally, the nearer to the
top of the system that one finds himself the more he can make his authority
known to all levels subordinate to him in his own and in other departments.
So it is in industry. If the auditor, or his immediate supervisor, or their
department head is equal to, or senior to the recipient of an audit report,
then it is easier to obtain attentiveness to the report. This points out the need
to have the internal auditor report not to a department head, such as a
comptroller, but to a vice president who is not encumbered by a department.
One who can exercise clear judgment on audit reports so as to insist that the
offending department correct its methods, or to rule that the auditor's case is
more academic than factual, and that no real danger exists. This he would do
on his own authority and the proper correspondence would be made a part of the
record of the case in point.

In the past auditor's have been stifled in their efforts to correct certain
situations in a particular department due to a long-standing ill will which may
have occurred years ago over something that may have been said about that
department in an audit report, which may have caused resentment by that depart-
ment head. At times audit work can be very unpopular. When these grudges
occur the repeated efforts of the auditor, working in that department, may only
receive token acknowledgement because the department head is far senior to the
auditor, and he knows that even the auditor's department head cannot force him
to comply with the conditions of an audit report. At worst, the matter will go to
a vice president, and the department head probably feels that he can defend his
point of view satisfactorily, so the auditor must suffer frustration as he reports and reports the same conditions time after time, until his cause for concern develops into a full scale situation such as he predicted it would.

There is little satisfaction in saying, "I told you so."

Another test of the auditor's effectiveness comes from the support he receives, not only from other department heads and their superiors, but from his own department head. Usually the auditor will be located on the accounting department's staff, so that his department head will be a general accounting manager, a comptroller, or some other title which identifies the same job. Unless this comptroller supports the auditor in his work, the auditor will be totally ineffective. If it ever became common knowledge throughout the company that the comptroller would not show an interest in the auditor's work, and lend his position and status to a situation which was brought to his attention as being important to the operation of the business, then there might just as well not be an internal auditing group, for it cannot succeed. Without support from its own department little can be expected from the other departments, for they will not be so naive as to go looking for criticism about their own operations.

Relationship between the Auditor and Local Managers

By way of review, it is important to develop the relationship which must exist between the auditor and the man who is in charge of the local office. This is important because each has a contribution to make to the other. From the manager, the auditor can expect complete cooperation with regard to every
employee of the manager's office. This will also include making all records and supporting data available, consistent with the demands of business. If the records cannot be given up for examination during the day, then it is obvious that these will have to be used after regular business hours, and this the auditor is familiar with. However, the spirit of cooperation and willingness must be in evidence, for the manager will want the most accurate appraisal of his area of responsibility that can be obtained. And to accomplish this requires cooperation.

The manager in his turn can expect much from the auditor. It is only natural that he will look forward to receiving an accurate, unemotional, and unbiased appraisal of conditions as they existed in his office at the time of the audit, as determined by an outsider to his department who was qualified to do so. At the conclusion of the audit the manager is also entitled to know the thoughts and facts that are entered in the auditor's field notes. After all, these are not major state secrets, they are notations concerning the activities of many little people who contribute their efforts in behalf of large businesses. It is therefore proper, and to be expected, that their activities and relative abilities be reviewed in detail with the one individual who is charged with the responsibility of accomplishing a certain objective by his use of these employees. If this closeness is not shared with the manager, the auditor will lose whatever aura of respectability which may have existed previously, and he will once again become the hireling of top management, who has lost the touch of humility by not permitting responsible and dedicated employees to know their own status except through his official
reports to their business superiors. Certainly this is a cruel and thoughtless way to abuse a position of trust, but some auditor's still use it. However, the manager who has had to defend his employee's actions, and his own, from the words of an auditor's report to his seniors in the past, without first having been apprised of the contents of the report by the auditor, can never again be expected to look upon a visit from the auditor as an occasion for assistance, and a wonderful opportunity for the company to benefit will have been lost.

Who Audits the Auditor

From time to time other employees in the business will mention that they are always on the receiving end of the auditor's attentions, and their thoughts will quite naturally include a question as to the auditor's position. After all, he is an employee of the company also. Who audits the auditor? In actual practice no one really audits him, for he does not originate any work or enter into the handling of company assets as a regular part of his assignment. However, the auditor cannot help being scrutinized by everyone with whom he comes in contact. Obviously his supervisor will watch his actions and performance. Top management will watch him and know his reputation, but they cannot see him at close range for long.

In truth, no one really audits the auditor; this is another of the ways in which he is unique. If the auditor were to take advantage of his position of trust and violate the rules of conduct in the manner which he tries to prevent other employees from doing, he might be quite successful at it. In the past we have all heard
of dishonest policemen -- some have been successful for years, but detection was inevitable. With auditors it is wise to rotate them in their assignments over the years so that the same auditor does not keep returning to the same offices time after time. In addition, more than one auditor should work on a case in which access to the company's money is readily available. When working with open cash it is always good practice to have more than one person present, no matter who that person might be. Thus the case of auditors can be stated as one in which men selected for this type of work are known to be of the highest personal character and integrity, but this must be tempered by not placing the auditor in the way of temptation any more than one would do with any other responsible member of management's senior organization.

The Future of Internal Auditing

When we consider the complicated structures of today's large corporations with their thousands of employees performing countless operations in the conduct of the company's business, one cannot help being overwhelmed by the need for organizational and administrative control. In point of fact control does exist, we have had it right along. The classic concept of internal control has long been based on the principle of the division of duties, in order that each employee's work may be checked or controlled by other employees. In spite of this type of control we have read of individual cases of embezzlement involving losses of millions of dollars. This gives rise to serious doubts concerning the system of controls used in these instances, and of the abilities of those individuals who were supposedly employing the controls.
If the files of some of our leading bonding companies could be made available to the top management of the average American corporation it would probably produce the greatest shock of their business careers. Case after case of theft, embezzlement, and abuse would be revealed, which amount to millions of dollars each year. Defalcations run the full gamut from janitor to president, and still we find those corporations in which the internal auditing duties receive only a tolerated and condescending attitude from the managers of the business. The bonding companies complain about this to the corporate managers, for the bonding companies have to pay for the lost assets after the case is brought to light, but the payments are made from the premiums paid by these same corporations for this fine protection.

Yes, the internal auditor is here to stay, and his work will take on greater complexities, for many of his former, readily obtainable records of operational performance are now being unintentionally hidden from him in punched cards and other electronic data. Nonetheless, it is absolutely essential and imperative that these unique employees of the corporation be supported by those senior members whom they represent. After all, the work and efforts of internal auditors are primarily in the name of top management. It is encumbent on that senior body to know how effective their servants are, and that they are receiving all of the support that they need in this vicarious assignment.
The Internal Auditor: Present and Future

The magnitude of the tasks confronting the internal auditor should indicate and determine the type of man who will be selected for this assignment. This is no place for the opportunist or company politician, nor is it a soft berth until retirement for the misfit who cannot perform successfully anywhere else in the company. This is one of the company's most challenging and valuable assignments, and its membership should reflect it. Leadership is essential in this work, the team head must be steeped in the knowledge of company operations, and he must assign his auditors on a schedule that will enable them to acquire that knowledge also. Young men who are added to this group must be guided along the path that will inspire them to go deeper and deeper into the reasons behind the company's way of doing things if they are ever expected to become qualified as auditors.

No other person within the company can accomplish those things which the auditor can do. For him, then, there is no alternative but that his every endeavor must always be of the highest quality.