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**SHOULD ENVIRONMENTAL AUDITING BE WITHIN THE
SCOPE OF INTERNAL AUDITORS' RESPONSIBILITY?**

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Abstract

Internal auditing is an independent appraisal activity usually performed by a specific internal auditing department within an organization. Its basic goal is to serve the organization by making sure that its internal controls are operating effectively, in order to ensure that its employees' responsibilities can be carried out productively. The Institute of Internal Auditors has many publications which guide its members in defining the scope of their work, giving them a general understanding of the roles and duties of internal auditors. These publications do not directly address the area of environmental accounting, but do appear to imply that internal auditors should accept at least a small role in an environmental audit, should an organization conduct one. The question, then, is how much responsibility must an internal auditing department take for an organization's environmental audit? Because environmental concerns are growing in the United States, as well as around the world, a great amount of environmental legislation governs companies' operations, past, present and future. Substantial liabilities for restoration projects have become realities for even the most "innocent" organizations, and it seems great technical competencies in understanding and interpreting the legislation are likely required for complete organizational compliance. Unfortunately, most internal auditors probably lack the time and resources to gain these necessary technical competencies, and thus could not conduct a thorough environmental audit on their own. Therefore, as research has shown, it appears that companies are most comfortable with a unique Environmental Audit department in charge of the audit, or at least conducting the audit using a combination of internal auditors' procedural skills and environmental specialists' technical competencies.

Internal auditors have traditionally been responsible for performing many duties within their organizations. They have done attestation work much like that performed by independent public accountants in auditing financial statements. In addition, internal auditors have had the extra responsibility of ensuring the organizations' resources are employed efficiently and its employees are using the most effective means to carry out their day-to-day responsibilities. Now there is the possibility that an additional duty will be expected of internal auditors, that of environmental auditing. Although this is a broad term, environmental auditing basically entails confirming that the organization has adequate controls to ensure it is complying with all federal and state environmental legislation. This expectation will no doubt place a burden on internal auditing departments in terms of struggling to gain expertise to fulfill this highly technical new obligation, as well as attempting to obtain the resources necessary to continue competently fulfilling the traditional internal auditing responsibilities. It is for these reasons that environmental auditing should not be within the scope of internal auditors' responsibility.

Internal auditing is an independent appraisal activity usually performed by a specific internal auditing department within an organization. Its basic goal is to serve the organization by making sure that its internal controls are operating effectively, therefore ensuring that individuals' responsibilities can be productively carried out. In

so doing, the internal auditor is guided by many publications of the Institute of Internal Auditors (IIA), an association set up to promote professionalism among internal auditors. Three of its main publications include Standards for the Professional Practice of Internal Accounting (Standards), a Statement of Responsibilities of Internal Auditing, and a Code of Ethics.

These publications, along with clarifying supplements, provide the profession with a general understanding of the responsibilities and duties of internal auditors. They also establish auditors' independence from the activities they audit and provide other standards for improving the practice of internal auditing. The IIA publications are therefore the basic sources for determining what internal auditors are expected and/or required to do in fulfilling their professional roles.

The IIA Code of Ethics, adopted in 1988, was designed to ensure high standards of conduct by internal auditors in fulfilling their responsibilities to those interests they serve within the organization. It calls for, among other things, exercising honesty, objectivity, and diligence in the performance of duties, not knowingly engaging in acts or activities which are discreditable to the profession, being prudent in the use of information acquired in the course of one's duties, and only undertaking those services which one can reasonably expect to complete with professional competence.

The IIA Statement of Responsibilities of Internal Auditing summarizes the

Standards by giving a general understanding of internal auditors' basic responsibilities. It states the overall objective and scope of internal auditing, involving furnishing management and the board of directors with analyses, appraisals, recommendations, counsel, and information concerning the activities auditors have reviewed. Also, there is a Responsibility and Authority section, calling for a written charter defining the purpose and authority of the internal auditing department which should be approved by senior management and the board. It also acknowledges that the implementation of the Standards should be governed by the environment in which the internal auditing department carries out its tasks, recognizing that organizations are very diverse in culture, customs, size, purpose and structure. Lastly, the Statement stresses internal auditor independence, meaning keeping an objective mental attitude and hence not subordinating one's judgement on audit matters to that of others.

The IIA Standards for the Professional Practice of Internal Auditing, supplemented and clarified by the IIA Statements on Auditing Standards, are what join internal auditors in all organizations together for a common purpose. They are detailed declarations published to impart to internal and external auditors, all levels of management, public bodies, and related professional organizations just what the roles and responsibilities of internal auditors are. Internal auditors must look to these Standards for guidance as to what duties they should be performing and what activities

are beyond the scope of internal auditing. It is this often thin line that is challenged with the potential burden of including environmental auditing among the many other internal auditing responsibilities.

Environmental auditing has been defined as "an integral part of the environmental management system whereby management determines whether the organization's environmental control systems are adequate to ensure compliance with regulatory requirements and internal policies," sort of a "self-evaluation process whereby an organization determines whether or not it is meeting its legal and internal environmental objectives" (Thomson, Simpson, and Le Grand 19). This definition indicates that management should be responsible for the audit results, but leaves room for deciding who will actually perform the audit.

There are actually many different types of "environmental audits," and Thomson, Simpson and Le Grand have identified at least seven possible categories, some more universal than others:

1. **Compliance Audits** - detailed, site-specific assessments of current, past, and planned operations which assess whether activities and operations are within the legal constraints imposed by regulations.

2. **Environmental Management Systems Audits** - focus on the systems in place to ensure that they are operating properly to manage future environmental risks.

3. **Transactional Audits (Acquisition and Divestiture Audits)** - an environmental risk management tool which helps buyers, lenders and others understand the environmental risk associated with the property they are purchasing, lending on, or accepting as a gift.

4. **Treatment, Storage, and Disposal Facility (TSDF) Audits** - involve the tracking of hazardous substances throughout their existence.

5. **Pollution Prevention Audits** - operational appraisals that serve to identify opportunities where waste can be minimized and pollution can be eliminated at the source.

6. **Environmental Liability Accrual Audits** - technical accounting and legal reviews involved with recognizing, quantifying, and reporting liability accruals for known environmental issues.

7. **Product Audits** - appraisals within the production processes of a facility which try to provide assurance that the product is in compliance with chemical restrictions and with environmentally sensitive interests.

All of these types of environmental auditing no doubt require great technical competence and skill in interpreting and applying either environmental laws or accounting/auditing procedures. Most of them probably require technical competencies from both areas. Still, a few of these types of environmental audits seem much more

likely to be performed by experts in environmental or operational matters, such as the Transactional, Pollution Prevention, and Product Audits. It is the other types of audits that might cause the question to be raised as to whether internal auditors should be carrying them out, or whether others should be responsible for them.

There are two main reasons why internal auditors should not have to take on the burden of environmental auditing. First, although usually highly competent in most auditing areas, internal auditors most likely have not had enough technical specialization to complete a thorough environmental audit. Thus, it seems unlikely that the internal/environmental auditors would be able to comply fully with the Professional Proficiency Standard of the IIA, which states that "the internal auditing department should provide assurance that the technical proficiency and educational background of internal auditors are appropriate *for the audits to be performed*" (emphasis added). Also, it seems that if internal auditors are forced to take on the new responsibilities conducting an environmental audit would entail, they would either have to shirk some of their former duties to make time for this new audit or find new resources allowing the department to expand enough to fulfill both obligations. Since resources are not that easy to find in these cost-cutting, downsizing days, it is likely that some important auditing functions would be replaced with environmental audit procedures.

As environmental issues become more and more important and prevalent

throughout society, the environmental audit no doubt becomes more complex each year, even for organizations not involved directly with major environmental concerns. Since the passing of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) in 1980, the so-called "Superfund" law, there has been much more burden on a company and therefore on its accounting personnel to make sure environmental liabilities have been recorded properly on the financial statements. This statute and court decisions which have interpreted it have given a broad definition to those who are responsible for cleaning up hazardous wastes from the environment.

CERCLA and its court interpretations have established the strict liability idea of "potentially responsible parties (PRPs)" - any present or prior owner of any land, facility or vessel associated with a hazardous spill, any persons who either transported hazardous wastes to the spill site or participated in the decision to use it for disposal, lenders, lessees under long-term leases, and successor corporations whose predecessors would have been liable if they still existed (Hines and Jackson 53). Other federal and state statutes have imposed similar liability for environmental concerns other than hazardous wastes, such as the Resource Conservation and Recovery Act and the Toxic Substances Control Act.

Obviously, with the strict record-keeping and reporting requirements of CERCLA concerning hazardous substances which, when not complied with, can result in

exorbitant fines or even prison sentences, a company must have a strict, all-inclusive internal control system to protect its environmental management system from unintentional or deliberate error. Since environmental restoration costs are so high, often exceeding \$50 million for one site, it seems likely that companies will try to do everything possible to lose their PRP status (Hines and Jackson 54). If this is not possible, or if the company is not a PRP but has another potential obligation to restore the environment resulting from past or present actions, it becomes the environmental management system's responsibility to make sure these liabilities, contingent or definite, are reported accurately on the company's financial statements.

As Hines and Jackson point out, "the greatest risk for audit error arises when the auditor tests management's completeness assertion - the assertion that all material liabilities have been identified and properly accrued or disclosed in the financial statements" (54). In April 1993 there were over 11,000 pages of federal environmental regulations, plus those of states and local governments which companies had to fully comply with to avoid risk of fines and other penalties (Thomson, Simpson, and Le Grand 22). There have no doubt been several more pages added to those, as well as revisions and deletions to the existing laws. It seems clear that it would require a technical expert in environmental matters to ensure a company is complying with all relevant laws, especially, but not at all limited to, a manufacturing company. If an

internal auditor has not had extensive training in environmental law, how can he or she be sure all liabilities have been accrued or disclosed without knowing whether the company has brought to light each possible one which should be considered under law? And therefore, how can he or she purport to establish the effectiveness of the internal control system for the environmental management system?

Assume the internal auditing department does take on the extra responsibility for completing the company's environmental audit, educating its staff in the intricacies of environmental law and allowing them time and resources to keep up with the ever-changing regulations. After all, this does appear to come under IIA Standard 320, which states that "Internal Auditors should review the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports and should determine whether the organization is in compliance." But, without putting extensive pressure on the current internal audit staff to complete both the old and new audit duties, it is obvious that some established audit procedures may have to be passed over in order to do a thorough environmental audit. This would of course make the traditional internal audit less complete, and could possibly lead to missing problems in the organizations' control and accounting systems. This could have disastrous effects for both management and the board, as they trust the effectiveness of the internal audit to report explanations of

organizational systems' problems and the solutions they have found. This would also effect external auditors, who often place much trust in the work internal auditors have done.

If the internal audit department should not be responsible for a company's environmental audit, who should be? Akers and Klos point out that "at a minimum, internal auditors should be alert to identifying or recognizing potential environmental problems resulting from an organization's processes or products." To do this, they suggest that "a limited number of environmentally oriented questions should be added to the internal auditor's general compliance audit program." They also say that if management does indeed implement an environmental auditing program, "the internal audit function should, at a minimum, support the program by providing resources in such audit techniques as audit planning, risk modeling, program development, statistical analysis methodologies..." This makes sense, as internal auditors could combine their auditing expertise with that of environmental engineers and others competent in environmental matters to build a highly efficient and successful environmental auditing department. This would require little to no sacrifice in the internal auditing department and would result in an environmental audit combining the "best of both worlds."

Although little empirical evidence exists as to who is and who should be conducting environmental audits, some research has been done on the subject. Akers

and Klos recently did a survey of the directors of internal auditing in the top 100 in sales of the Fortune 500 Industrial Companies. The response rate was relatively good, at 59 percent, and the survey showed that 90 percent of the companies responding did indeed conduct environmental audits. The survey was clear on one thing, that most (79%) environmental audits were currently conducted by technically-oriented departments, such as Environmental Health and Safety, Environmental Affairs, or Plant Operations Departments, with only 17 percent conducted solely by Internal Auditors. When asked who the respondents thought should be responsible for environmental audits, 32 percent said an Environmental Audit department and 22 percent said a combination of an Environmental Department and the Internal Audit Department. Only 5 percent thought the Internal Audit Department should alone be responsible for conducting environmental audits. These findings confirmed those of an earlier study done by CH2M Hill and published by the Institute of Internal Auditors Research Foundation which found that "the most common organizational practice is to have the environmental auditing process 'owned' by a technical-oriented group, department, or other organizational unit" (qtd. in Akers and Klos 27). It seems clear that companies are leaning toward a combination of the technical expertise of Environmental Affairs Departments with the auditing knowledge of Internal Auditing Departments to create a synergy in a distinctive Environmental Auditing Department.

As environmental accounting becomes more crucial in the everyday operations of a business organization, management and the board of directors are challenged to ensure the company develops and effectively carries out its own sound environmental policies and procedures. The growing number of potential environmental liabilities a company faces, along with the need to constantly monitor compliance with all environmental laws, proves the need for a strong environmental management system. Along with this relatively new type of system, there emerges the potential for misuse and abuse and thus a need for monitoring the system's effectiveness. By combining the resources of a company's internal auditing department with more technically specialized environmental departments, an Environmental Auditing function can develop with the potential to greatly ease the environmental burden placed on the company as a whole.

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