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INTERNAL CONTROL: HOW IT EVOLVED IN FOUR ENGLISH- SPEAKING COUNTRIES

Abstract: The concept of internal control, as embodied in auditing standards and other statements by professional accounting bodies, has varied over time and geographically. There are, however, a number of similarities in the events that shaped professional statements concerned with internal control in the United States, United Kingdom, Australia and New Zealand.

The evolution of internal control has been influenced by increasing public expectations of auditing standards. Another influence was a trend in the evolution of management control concepts towards recognizing a broader range of influences on the control of organizations: These trends have been opposed by auditors, who wished to avoid increasing their responsibilities.

Recent discussions of internal control in accounting and management literature have concerned aspects of control that go beyond simple checking procedures. For example, Thompson [1967], Ouchi and Maguire [1975], Ouchi [1977, 1979, 1980, 1981], Boland and Pandy [1983], Mintzberg [1983], and Macintosh [1985] discuss complex models of control that consider human factors. The history of the changes in models of control was described by Parker [1986a, 1986b, 1986c]. A similar trend towards recognizing a wider view of control has also developed in auditing. This trend is reflected in professional auditing standards, for example, in the development of terms such as "control environment".

This paper presents the results of a study that examines and compares the evolution of internal control in statements by professional accountancy bodies in the United States, United Kingdom, Australia and New Zealand. Internal control, as embodied in auditing standards and other statements by professional ac-

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counting bodies, has varied from country to country, and has been modified at different times, but has resulted in professional statements that are all quite similar. This study looks at why changes in the professional promulgations concerning internal control occurred. The origin of these professional statements, and the causes of changes to them are examined by referring to professional journals and other materials published at the time these changes took place.

The statements about internal control by professional bodies are of particular relevance now, since further changes are being considered, particularly in the United States. Following a recommendation by the Treadway Commission, the Committee of Sponsoring Organizations of the Commission is examining the issue of internal control and developing new definitions [COSO, 1991]. It is likely that these new standards will influence those adopted in other English-speaking countries, as U.S. auditing pronouncements have previously influenced the developments in other countries. That influence is discussed later in the paper.

The professional statements of the American Institute of Accountants and its successor, the American Institute of Certified Public Accountants, are examined in this study, because the accounting profession in the United States was influential in the evolution of internal control. The United Kingdom, Australia and New Zealand are also included in this study because the auditing profession is well-established there. These countries adopted auditing statements concerning internal control later than in the U.S. In addition, influence of statements by the International Auditing Practices Committee of the International Federation of Accountants, and the status of internal control in other select countries are examined briefly in this study.

Internal control was first included in professional statements in the 1920s and 1930s, but most of the developments have taken place in the 1950s and later. As a result, the paper examines the period from 1949 (when the American Institute of Accountants issued its definition of internal control) to 1988, when the 1949 definition was superseded. However, earlier sources are considered where appropriate.

The research question, "how did internal control evolve?" is applied to auditing promulgations in each country by analyzing it into the following sub-points:

How was internal control defined in professional statements?

How did it change during the period [1949-1988]?

What influences on the professional statements about internal control were reported?

Information about each sub-point is examined with respect to the major changes in professional statements concerning internal control for each country. Used in this study are the professional accounting journals of each country along with other sources, such as auditing textbooks, which have been used by previous studies of auditing history [e.g. Brown, 1962; Hackett and Mobley, 1976; Myers, 1985].

PREVIOUS RESEARCH

Previous studies of the history of internal control include Hackett and Mobley [1976] and Bintinger [1986]. These studies were concerned with developments within the United States. They concentrated on developments following the promulgation of the definition set out in 1949 [AIA, 1949], and the subsequent "clarification of the previous definition" which divided internal control into accounting controls and administrative controls.

Trends identified by previous studies of auditing history in general are also relevant. Dirsmith and McAllister [1982, p. 218] noted that changes in published auditing doctrines were frequently related to action external to the profession, which in turn reflected changes in society's expectations concerning the profession. The history of auditing was depicted by Lee [1988, p. xxiii] as taking place against a background of constant resistance by audit practitioners to expanding the auditor's duty of care and skill. A long-standing trend for auditors to reduce emphasis on fraud detection, established since the 1890s, was also identified by Lee [1988, p. xxvi], and Moyer [1951, p. 7]. Myers [1985] perceived that audit procedures developed in a pattern which he called "spiralling upwards". He suggested that there is a general trend whereby auditing procedures apparently repeat earlier stages of their development. This pattern does not, however, represent a simple reversal of earlier changes, since at each stage of the cycle a more sophisticated approach is taken.

Changes in management theories of control have also indirectly influenced the evolution of internal control. The broad

definition of internal control discussed below [AIA, 1949] was consistent with the classical model of management control that was then current. In 1949, the authoritative literature on management principles was largely based on "scientific management" and the work of Fayol [1916] and Taylor [1916] (according to Parker [1986a, p. 77]). Parker [1986a] noted that the control models of Taylor and Fayol "have little regard to the human dimension of control". As a reaction to scientific management and the classical model, the "behavioral model" developed [Parker, 1986a]. The recent definition of "internal control structure" appears to reflect the view that other factors (such as management philosophy) influence the control of an organization, in addition to management's system of authority. This is in accordance with the behavioral model of management control [e.g. Ouchi, 1980; Mintzberg, 1983; Macintosh, 1985].

THE UNITED STATES

The United States was the first country to introduce professional guidance on internal control. Internal control started to become significant to auditors in the United States early in the twentieth century [Staub, 1904, p. 98; Vincent, 1952, p. 3; Brown, 1962, p. 699; Myers, 1985, p. 69]. Its importance was associated with American audit procedures, which were beginning to develop independently from those used by the British profession. In particular, procedures became oriented to financial reporting rather than to fraud detection [Moyer, 1951, p. 7; Brown, 1962].

In 1936, the American Institute of Accountants defined "internal check and control" as:

Those measures and methods adopted within the organization itself to safeguard the cash and other assets of the company as well as to check the clerical aspects of the book-keeping [AIA, 1951].

The statement which included this definition was a formulation of what was generally accepted in 1936, and was not an attempt to change existing procedures, according to the expert witnesses in the SEC's hearings into the *McKesson and Robbins* case [Edwards, 1960, p. 165].

The Institute subsequently published more authoritative auditing standards, partly as a result of the Securities and Exchange Commission's report into the *McKesson and Robbins*

case [AIA, 1951, p. 4; Berryman, 1960, p. 76; Hackett and Mobley, 1976, p. 4]. These were published as a tentative statement in 1947 and “lost their tentative status” after a vote of Institute members in 1948. The standards included a requirement for a “proper study and evaluation of internal control” [AIA, 1947, p. 16].

This requirement in the standards was then supplemented by a definition from the AIA’s Committee on Auditing Procedure. The Committee’s definition of internal control, (which stood for another 39 years) was:

Internal control comprises the plan of organization and all of the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies [AIA, 1949, p. 6].

The 1949 definition extended internal control to include the objectives concerned with operational efficiency and with prescribed managerial policies. It represented a concept of control which was considerably broader than the previous professional statement.

The 1949 statement coincided with an upsurge in accountants’ interest in internal control which resulted from both economic developments and changes in audit techniques. Previous studies of the history of auditing reported that internal control had become important as a result of failures and flaws in auditing procedures which were revealed by the *McKesson and Robbins* case [Berryman, 1960; Hackett and Mobley, 1976]. A much wider range of other causes was indicated by a review of contemporary sources. Internal control was described as a means of assisting auditors [AIA, 1949, p. 6; Jennings, 1953, p. 38; Bevis, 1955, p. 46]. It was recognized that the “detailed audit” — a test of all transactions — was no longer cost-effective [Cranstoun, 1948, p. 274; Sprague, 1956, p. 55]. Reliance on internal control was now possible because systems of internal control were now generally more effective [Jennings, 1953, p. 38] because business organizations had recently become larger [Jennings, 1950, p. 192] and more complex [Cobb, 1952, p. 341]. Bevis [1955, p. 46] attributed the increased concern with internal control to the change in the objective of auditing from detection of fraud and error to reporting on the overall reliability of the financial statements. World War II was also an influence,

since it led to a shortage of audit personnel to do detailed testing [AIA, 1942, p. 119].

The internal control definition published in 1949 was criticized later by Byrne [1957] and Levy [1957] who suggested that it caused misunderstanding about the extent of auditor responsibility and that it could increase the legal liability of auditors. Grady [1957], (chairman of the Committee on Auditing Procedure when the statement Internal Control was published in 1949), responded in support of the definition. In 1958, the definition was narrowed; another statement divided internal control into two parts: accounting controls and administrative controls. The Committee on Auditing Procedure went on to state that an auditor is primarily concerned with accounting controls, "because they bear directly on the reliability of the financial data," [AICPA, 1958, p. 67]. The objectives that had been added in 1949 to the early definition ("to promote operational efficiency" and "to encourage adherence to prescribed managerial policies") were reclassified as administrative controls, which were not seen as part of an auditor's primary responsibility.

The "clarification" was a reaction to the new, broad definition published in 1949. When AIA members had adopted auditing standards in 1948, and included a requirement for a "proper study and evaluation of internal control," internal control was narrowly defined. When the later broad definition was added in 1949, the standard resulted in an expansion of auditors' duties. The 1958 clarification restored the *status quo*. It also appears that evaluation of internal control in accordance with the broad definition had not been applied in practice (according to a survey of auditing firms [Vincent, 1952]).

The definition was modified again in 1973. The AICPA revised the distinction between accounting control and administrative control (singular, not "controls" as in the earlier version). One objective of internal control, the "safeguarding of assets," was narrowed to "the procedures and records that are concerned with safeguarding assets". Mautz and Winjum [1981, pp. 9-11] suggested that the AICPA's main intention was to reduce further the scope of internal control. Other authorities emphasized the new definition's broadening effects. Loebbecke [1975, p. 83] suggested that all controls need to be examined to determine whether they have an impact on the financial statements.

In 1977, a requirement for corporations to comply with the AICPA's [1973] definition of internal accounting control was

passed into law. There had been a public outcry over findings (first identified by the Watergate special prosecutor's office) that more than 400 companies had made questionable or illegal payments totalling more than \$300 million. *The Foreign Corrupt Practices Act* was intended to use accepted accounting terminology in a requirement that would prevent "off-the-books slush funds and bribes" [SEC, 1979, p. 610].

This development was followed by a report, from an advisory committee of the AICPA, which revived the broader concept of internal control. The report of the Special Advisory Committee on Internal Accounting Control used the term "internal accounting control environment" [AICPA, 1979, p. 2]. This included factors such as organizational structure and leadership from top management, both believed to lead to appropriate "control consciousness" [AICPA, 1979, p. 2, Cook and Kelley 1979, p. 62].

The 1980s led to further changes in the AICPA's requirements for internal control evaluation, including explicit broadening of the definition of internal control. The changes were, again, partly due to public concern about auditing standards. The National Commission on Fraudulent Financial Reporting (Treadway Commission) was set up in 1985 by the AICPA and other accounting organizations. The Commission commented that some instances of fraudulent financial reporting involved transactions "under management's direct control and not part of the system of internal accounting controls" [National Commission on Fraudulent Financial Reporting, 1987, pp. 29-30].

In 1988, the AICPA replaced the definition of internal control with a new, broader description of "internal control structure." This was defined (in *Statement on Auditing Standards 55*) as "the policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved." [AICPA, 1988, p. 4].

The statement also changed the generally accepted auditing standard concerning internal control. The previous requirement for "a proper study and evaluation" of internal control was replaced with "a sufficient understanding of the internal control structure" [AICPA, 1988, p. 3].

The change from using the expression "a proper study and evaluation" to "a sufficient understanding" was not intended to imply that a reduced scope was now required. The rationale for the changes was explained by AICPA office-holders as "to

broaden the auditor's responsibility to consider internal control when planning" [Guy and Sullivan, 1988, p. 38], and as "expanding the auditor's responsibility for determining how internal control works" [Temkin and Winters, 1988, p. 86].

Developments are still taking place. The accounting institutions which sponsored the Treadway report recently issued a draft report that provides "integrated guidance" on internal control [Committee of Sponsoring Organizations, 1991; *Journal of Accountancy* 1991].

To summarize, the United States was the first country in which the audit profession developed a definition of internal control and a standard regarding auditors' examination of it. Developments in the United States were distinctive because more statements concerned with internal control were issued, and there were more changes of approach. Initially, in 1936, a narrow definition of internal control, consistent with existing practice, was adopted. It was replaced by a broad definition, in 1949, that was more consistent with a management definition of "control". After resistance by the profession, the scope of internal control as it concerned auditors was narrowed again in 1958. A revision in 1973 is regarded somewhat equivocally. More recent pronouncements, including the changes to the auditing standards in 1988 and the continuing work of the Committee of Sponsoring Organizations, are seen by AICPA officials as broadening the definition of internal control once more.

THE UNITED KINGDOM

Auditing procedures evolved differently in the United Kingdom from the developments in the United States. Under the companies legislation in the United Kingdom, auditors did not report on the profit and loss account until 1948 [Chastney, 1975, p. 12; Briston and Perks, 1977, p. 59]. As a result, there appears to have been less concern with internal control [Lee, 1988, p. xix].

References to internal control in British professional journals were relatively infrequent before the 1960s, and were not based on binding professional standards. Lawson [1951] and Taylor [1954], however, indicated that some British auditors did rely on internal control. In 1953, the Institute of Chartered Accountants in England and Wales (ICAEW) published a statement discussing internal audit, which included references to internal control and internal check [ICAEW, 1953]. It included a

broad definition of internal control, which was later developed further by the British profession:

Internal control is best regarded as including the whole system of controls, financial and otherwise, established by the management in the conduct of the business, including internal audit, internal check and other forms of control.

Although the terminology used was different from the AIA [1949] definition, it was a broad definition with a similar meaning. There was still no binding audit standard requiring audit examination of internal control.

In 1961, the ICAEW issued a more general *Statement on Auditing* [ICAEW, 1961]. This statement was issued “for guidance” and did not claim to be an authoritative auditing standard. The statement recommended that auditors “make a critical review of the system of book-keeping, accounting and internal control.” The definition of internal control appeared to be a combination of the previous ICAEW definition and the American Institute’s [1949] definition:

By “internal control” is meant not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records [ICAEW, 1961, p. 242].

Internal control was an innovation for some British auditors. Waldron [1961, p. 718] suggested that some practitioners “may be regretfully shaking their heads” because the statement’s advice on audit procedures was not appropriate for them.

In 1964, the ICAEW issued a further *Statement on Auditing* [ICAEW, 1965] which dealt specifically with internal control. It repeated the earlier [ICAEW, 1961] definition of internal control. The statement was described as primarily concerned with financial and accounting control:

That is, those matters which relate to the custody and control of the company’s assets and the recording of its transactions [ICAEW, 1965, p. 234].

This concept of control approximated that covered by “accounting controls” in the AICPA’s [1958] clarification of the definition.

The subsequent adoption of auditing standards in the UK was preceded by public concern about auditing procedures. In 1976 and 1977, there was severe criticism of auditors and audit procedures in news reports and Parliamentary proceedings, following company failures such as the collapse of London and County Securities Limited in 1976 [Hay Davison, 1977, p. 84; Briston and Perks, 1977, p. 59]. As Hay Davison put it, the UK was "the last among the great accounting countries of the world to introduce auditing standards." [Hay Davison, 1977, p. 91]. (A partner in a major audit firm advised Stamp and Moonitz [1978, p. 67] that the international accounting firms already sought to follow the auditing standards of the AICPA.)

Subsequently, the Consultative Committee of Accountancy Bodies (CCAB) published a set of auditing standards, after extensive consultation [*The Accountant*, 1980, p. 592]. The CCAB included the three Institutes of Chartered Accountants in England and Wales, Scotland and Ireland, together with other bodies such as the Association of Certified Accountants.

The draft of the standard included a requirement for the auditor to "ascertain, evaluate and test the operation of any internal control on which he wishes to place reliance". According to Woolf [1980, p. 63], this paragraph caused problems for practicing auditors. He suggested that its tone and position in the standards indicated to auditors that internal control was being given more emphasis than audit evidence, and that "systems-based auditing" was to be a requirement. After submissions by audit practitioners, the standards were modified slightly to imply a less demanding requirement:

If the auditor wishes to place any reliance on internal controls, he should ascertain and evaluate those controls and perform compliance tests on their operation [CCAB, 1980, p. 3.101].

Detailed auditing guidelines were published at the same time as the auditing standards. The guidelines included a definition of an internal control system and internal controls:

An internal control system is defined as being the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the

completeness and accuracy of the records [CCAB, 1980, p. 3.204].

This definition was similar to the ICAEW's 1961 definition. It was no longer considered necessary to include a reference to "internal check and internal audit" being included as part of internal control. The remaining objective, efficiency, was added after being used in the American standard [AIA, 1949].

Although the United Kingdom developed its own definition of internal control, this became increasingly close to the AICPA's 1949 definition. Auditing standards were not adopted until later than in the other three countries. When standards were adopted, the standard concerned with internal control was modified after the original proposal was criticized. The new requirement implied that less emphasis on evaluation of internal control was required. This change appears to have allowed the British profession to avoid the pressure to narrow the definition of internal control that was present in the United States.

AUSTRALIA

Australia was the second of the four countries to issue a professional promulgation requiring evaluation of internal control. However, the recommendation was, according to its author, based on practice in the United Kingdom, not on the American auditing promulgations; yet, it did not follow any British professional statement, and was to some extent at least an indigenous development. Australia subsequently turned to following the United States as its model.

The Australian Institute's first recommendation on auditing practice was issued in 1951, and revised in 1954 and 1969 [Robertson, 1974, p. 4]. Gibson and Arnold [1981, pp. 53-60] reported that professional auditing statements in Australia were initially influenced by one person, Mr. F. E. Trigg (a partner in Price Waterhouse). In 1942, the Institute of Chartered Accountants in Australia asked him to prepare a paper including recommendations on auditing standards and practices. The recommendations in Trigg's paper eventually were adopted as standards by the Institute [ICAA, 1951]. The recommendation was based on Trigg's understanding of English auditing procedures (which had not yet been documented by the British professional accountancy bodies). Trigg advised Gibson and Arnold [1981] that the recommendation was "in no way" influenced by American auditing.

The recommendation, published in 1951, required that "appraisal of the soundness of the accounting methods employed and the effectiveness of the system of internal control" was an essential duty, "which the auditor cannot escape" [ICAA, 1951, p. 10]. No definition of internal control was provided; a narrow approach was implied by references to internal control as the "internal checking system." In addition, the purpose of internal control was described as detecting fraud.

In 1954, a revised "Statement on General Professional Auditing Practice" was published [ICAA, 1954]. The requirements concerned with internal control contained minor changes. The statement now required that appraisal of internal control was "essential to enable the auditor effectively to plan his work" [ICAA, 1954, p. 10]. The reference to "the internal checking system" was replaced by "the system of internal control" [ICAA, 1954, p. 10], and there was still no definition of internal control.

At that time, the broader concept of internal control was not shared by managers and practicing accountants. A study conducted in 1953 [Savage, 1955, p. 363-4] found that Australian managers and accountants held a narrow view of internal control. They associated it with checking of records, not with the AIA's broad definition. The narrow view was consistent with the ICAA's statements.

In 1969, a statement with only minor changes, again prepared by Trigg, was published [ICAA, 1969]. It was soon replaced, in 1974, by a completely new set of standards, this time based on the AICPA's statements. Gibson and Arnold [1981] explained that this change from following a British to an American model was due to changes in trade and investment. The United States had become a more important influence on the Australian economy. In addition, existing standards of audit practice had been criticized by the judge in the *Pacific Acceptance* case in 1969 [*Chartered Accountant in Australia*, 1974; Robertson, 1974, p. 4]. Kenley [1975], however, described the Australian statement as promulgating standards that already existed but which had not been codified.

The standards included a requirement for auditors to evaluate internal control:

An auditor must systematically evaluate the nature of the client's business and system of internal control to determine the nature, scope and timing of audit procedures to be used [ICAA, 1974, p. 5].

The statement also made a distinction between accounting controls and administrative controls, quoting the AICPA's [1973] SAP 54.

The Australian Auditing Standards Committee, a joint body supported by the Australian Society of Accountants as well as the Institute of Chartered Accountants in Australia, reviewed auditing standards again. This was done to satisfy the judge's comments in the *Pacific Acceptance* case [Gibson and Arnold, 1981, p. 60], and because the public had higher, and increasing, expectations of auditors [Kenley, 1977, p. 35]. The new standards [ICAA/ASA, 1977] again included a standard requiring evaluation of internal control.

Subsequently, new standards were adopted based on international guidelines. Australian Auditing Standards now require that:

Auditors shall gain an understanding of the accounting system and related internal controls and shall study and evaluate the operation of those internal controls upon which they wish to rely in determining the nature, timing and extent of other audit procedures [Auditing Standards Board/Australian Accounting Research Foundation, 1983, p. 2012].

This standard resembles previous Australian statements in its requirement that auditors must examine internal control; its restriction to "the accounting system and related internal controls" provided a limitation to this requirement.

NEW ZEALAND

New Zealand, like Australia, based its internal control promulgations on oversea models. Again, the British profession was initially the source of the professional pronouncements; subsequently, United States promulgations were drawn on. The influence from the United Kingdom was more direct than it had been in Australia. Instead of describing English practice, ICAEW statements were adapted. Later, AICPA auditing standards served as the model in New Zealand.

Evaluation of internal control and reliance on it, together with a number of other modern developments in auditing practice, were recommended to New Zealand auditors at the New Zealand Society of Accountants convention by Chapman [1950]. Comments from New Zealand auditors recorded with his published paper indicated that, at that time, some auditors did not

accept that reliance on internal control would be feasible in the smaller businesses found in New Zealand. Subsequent references to evaluation of internal control as a recommendation for auditors became increasingly frequent in the 1950s [e.g. Perkins, 1950; Dixon, 1950; Parry, 1952; NZSA, 1953; Stewart, 1954; Perkins, 1956; McCaw, 1958; Gilkison, 1959].

New Zealand auditing in the 1950s and 1960s followed the approach that had been taken in the United Kingdom, both in the statutory requirements for auditing, and professional recommendations. A requirement to audit the profit and loss account was not introduced until the *Companies Act 1955* (modelled on the 1948 British Act) [Gilkison, 1962]. In 1962, the ICAEW [1961] *Statement on Auditing* was reprinted in the *Accountants' Journal*, and this was followed by the publication of a New Zealand Society of Accountants "Tentative Statement on Auditing Practice" [NZSA, 1964]. The statement, "General Principles of Auditing", was based on the previous English statement, and included an identical definition of internal control.

In the 1960s, internal control seemed to be accepted by some New Zealand auditors [e.g. Gilkison, 1962]. However, Martin [1963, p. 218] noted that internal control questionnaires, and other methods of documenting controls, were not yet widely used in New Zealand. Titter [1967a, p. 311] identified a need for auditing standards to be codified because there was an inconsistent pattern of auditing procedures. He also asked "How many auditors today do not make an annual systematic review and evaluation of internal control?" [Titter, 1967b, p. 350]. Titter implied that there were still many auditors who did not conduct these procedures.

Subsequently, New Zealand auditing was influenced by its American counterpart. Auditing Standards were adopted in 1973 [New Zealand Society of Accountants, 1973]; upon issuing the standards, the Society expressed appreciation to the American Institute of Certified Public Accountants for assistance that had been provided by SAP 33 (a codification of AICPA Statements on Auditing Procedure). New Zealand Auditing Standards required that:

There must be a proper study and evaluation of the existing internal control procedures as a basis for determining the extent of tests to which auditing procedures are to be restricted [NZSA, 1973, p. 354].

This standard was a shortened version of the AIA [1947] standard used in the United States. The standard [NZSA, 1973, p. 356] also included a definition which was identical with the American definition adopted in 1949 [AIA, 1949]. The distinction between "accounting controls" and "administrative controls" that had been added to the U.S. definition in 1958 [AICPA, 1958] was not included in the New Zealand standard.

In 1974, the Society issued a *Tentative Recommendation on Auditing Practice* dealing specifically with internal control. The recommendation [NZSA, 1974] acknowledged American, Canadian and British statements, but it included terms not included in the professional promulgations of the other countries discussed previously. For example, it distinguished between two levels of internal control. "First level" controls included authorization and personnel quality; "second level" controls included the plan of organization and managerial supervision. These innovations never made it into the final pronouncement by the Society. Statement RAP-7, *Internal Control and the Nature and Extent of Audit Tests* was issued in December 1977 [NZSA, 1977]. The new recommendation was, again, based closely on an overseas auditing statement: it repeated the American [AIA, 1949] definition of internal control.

Another set of New Zealand auditing standards was introduced as an exposure draft in 1984, and adopted in 1986. The requirement concerning internal control [NZSA, 1986a, p. 22] was drawn from *International Auditing Guideline No. 3* [IAPC, 1980]. No definition of internal control was included in the Standard, and concurrently the Society withdrew the previous statement [NZSA, 1977], which had contained a definition. A commentary [NZSA, 1986b] advised that a new guideline to replace the material on the nature of internal control in general would be issued. This guideline has not yet been issued, and the definition included in *International Auditing Guideline No. 6* has not yet been adopted by the NZSA either.

The New Zealand profession appears to have developed its auditing standards (including its requirement regarding internal control) out of a desire to ensure consistency with auditors elsewhere in the world. Chapman [1950] suggested that New Zealand auditors should follow generally accepted auditing standards based on overseas standards. Martin [1963] commented that speedier communications and the spread of inter-

national groups of companies had caused an awareness among New Zealand auditors that the New Zealand standards for auditing must be equal those of the United States, Great Britain and Australia.

OTHER COUNTRIES

Although the four countries selected have had variations in their auditing histories, they have a common language and somewhat similar accounting professions. What of other countries? Information from other countries does not indicate that the evolution of internal control has been substantially different. In non English-speaking countries, the AICPA (and later the IAPC) has been the predominant influence on the development of auditing standards and other professional pronouncements [Stamp and Moonitz, 1978; Creamer, 1987]. In Canada, the remaining country with a large and influential auditing profession, the professional body's auditing statements are similar to those in the countries examined above [CICA, 1979, p. 5200.05; Etherington and Gordon, 1985].

According to Stamp and Moonitz [1978], the international accounting firms were also influential in encouraging the use of AICPA standards in other countries. They noted that the AICPA's statements (or a literal translation of them) were in use in Brazil as well as most other Latin American countries, and in Israel and the Philippines; in addition, the international accounting firms in Japan practiced in accordance with U.S. standards [Stamp and Moonitz, 1978, p. 110].

International Auditing Guidelines were introduced in 1979, after Stamp and Moonitz [1978, p. 145] had previously recommended the adoption of a set of international auditing standards under the auspices of the International Federation of Accountants (IFAC). IFAC announced that the guidelines were to be promulgated by the International Auditing Practices Committee. The statement concerned with internal control, International Auditing Guideline No. 3, *Basic Principles Governing an Audit* [IAPC, 1980], included similar material to the AICPA's auditing standards. As discussed above, it has directly influenced auditing statements in Australia and New Zealand. Creamer [1987, p. 92] reported that International Auditing Guidelines had now been adopted by most other countries.

DISCUSSION AND CONCLUSION

This analysis showed that, during the period 1947 to 1980, auditing standards were established in each of the four countries selected; and, in each case, a standard concerning internal control was included. Definitions of internal control were published before and after the relevant standards. The evolution of internal control followed a distinctive pattern in each country; but there were also extensive similarities.

Similarities among the four countries included developments in the evolution of internal control that were preceded by public criticism of existing auditing procedures, resistance by the members of the profession to expansion of their duties concerned with internal control, and the increasing similarity of the definitions. These similarities are discussed in the following paragraphs.

The first similarity was the association between public criticism and change. The adoption of a standard concerning the examination of internal control, or a change in its definition, was frequently preceded by public criticism of auditing procedures. Developments in standards and definitions concerned with internal control often took place after there had been public criticism of audit procedures and concern about corporate management. This was the case in the United States in 1949 and 1988, the United Kingdom in 1980 and Australia in 1974. The pattern was consistent with other studies of auditing history, including Dirsmith and McAllister [1982] and Lee [1988].

Second, in three of the countries, the breadth of the definition was important. The profession appears to have resisted expanding its duties. Whether internal control should be defined narrowly or broadly was an important issue when changes to the American definition took place in 1949, 1957 and 1988. A broad definition was promulgated in 1949; this was narrowed in 1957 as a result of concern about increased liability for practitioners. Subsequently, a broad definition was introduced in 1988 as one of a number of measures to make auditing more effective. The issue of broad or narrow internal control has been dealt with in different ways outside the United States. Practitioners in the United Kingdom ensured that they adopted auditing standards which avoided implying a requirement for auditors to examine internal control [Woolf, 1980, p. 62]. Thus, a broad

definition of internal control was not a problem for them. Australian auditing statements since 1951 suggested that evaluation was necessary, yet the statements did not have the status of auditing standards, and internal control was not defined. Later, when an auditing standard requiring internal control evaluation was introduced, this requirement was moderated by adding the AICPA's narrow definition. This issue does not appear to have been important in New Zealand.

This recurring issue indicates that a strict requirement to evaluate internal control, together with a broad definition of internal control, is associated with resistance by auditors. This can be addressed either by narrowing the definition (as was done in the United States and later in Australia) or by reducing the emphasis of the auditing standard concerned with evaluation (as in the United Kingdom, and in Australia during the early period of professional guidance on auditing).

The third similarity is in the terminology used. Standards and definitions in each of the countries resemble each other. The similarities have increased over the period examined. This is partly because professional bodies used statements that apply in other countries as precedents. Because the AICPA was the first organization to establish auditing standards, the U.S. profession has been the most influential. While the accounting professions in each of the three other countries all developed at least one statement that was indigenous, the AICPA's pronouncements have become increasingly dominant. American influence on the economies of other countries and the spread of the international audit firms have also been cited as reasons for this trend.

The frequent changes to the definition of internal control, and to auditing standards concerned with it, reflect the presence of conflicting pressures. On the one hand, the definition of "control" in other literature is a broad one, and becoming increasingly so. In addition, when auditing procedures are criticized due to apparent faults, then changes that broaden the definition of internal control frequently take place. On the other hand, auditors are concerned to minimize the extent of their duties, and of their liability. As a result, they favor a narrow definition.

The changes in internal control also reflect the changing emphasis of auditing, away from the objective of detecting fraud. The AIA's 1936 definition described "internal check and

control" as concerned first with safeguarding cash and other assets. Since then, the changes in the definitions of internal control, (including the recent AICPA statement [1988]) have continually reduced the emphasis given to safeguarding assets, and indicated that the auditor's prime concern is the reliability of the data used to prepare the financial statements.

The evolution of internal control was consistent with the models of auditing history presented by Dirsmith and McAllister [1982] and Lee [1988]. External events (such as economic developments and the *McKesson and Robbins* case in the U.S., and other cases involving auditors in the UK and Australia) preceded the adoption of auditing standards requiring examination of internal control. Internal pressures (partly in response to an external influence, the increasing legal liability of auditors) were responded to by a narrowing of the definition in the U.S., and by a rephrasing of the proposed standard for evaluation of internal control in the UK. Subsequently, further external events in the U.S. (such as scandals about corrupt practices by corporations) led to a broader definition of internal control.

Earlier in this paper, the research question was identified as "how did internal control evolve?" This question was then analyzed into three sub-questions, each of which has been discussed above. In brief, the definition of internal control has become broader and closer to a definition of management control in all the countries examined. This change has been in response to external pressures, sometimes with resistance from auditors.

In general, the evolution of internal control demonstrates the influence of a number of trends in auditing history. These include the internationalization of auditing, and the extent to which developments in the United States have become important; the pressure from external sources for the area of auditors' responsibility to be increased; and the resistance by auditors to such an increase in their duties. The general trend in each of the four countries has been towards a "broader" view of internal control, a trend consistent with other control literature.

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