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Internal Auditing—A Historical Perspective and Future Directions

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An inquiry into the history and forward directions of internal auditing can best begin with a definition. In the new **Standards for the Practice of Internal Auditing** just issued by The Institute of Internal Auditors, internal auditing is defined as ". . . an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization." The Standards then go on to say that "The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed. The members of the organization assisted by internal auditing include those in management and the board of directors. Internal auditors owe a responsibility to both, providing them with information about the adequacy and effectiveness of the organization's system of internal control and the quality of performance." The reference to internal control is further clarified in the **Statement of Responsibilities** issued by the same Institute where internal auditing is described as ". . . a managerial control which functions in measuring and evaluating the effectiveness of other controls." All of these statements confirm the broad constructive nature of internal auditing.

The fact that the term "internal auditing" includes the word "auditing," and the fact that the work of the external auditor—the independent public accountant—also has to do with "auditing," suggests that the only difference between the two professional activities is whether the individual is an employee of the organization or is engaged as an outside professional on a contractual basis. The fallacy of that oversimplified view can be shown by comparing the respective missions of internal and external auditors. In the latter case—if we exclude the wide range of special consulting services—the primary mission of the external auditor is to examine the annual financial statements of the organization in such depth as to make possible the expression of an opinion as to their fairness in conformity with generally accepted accounting principles. That opinion in part is sought by the board of directors and corporate management for their own use, but even more for the outside parties who rely on the financial statements—creditors, investors, government, and the like. In carrying out this extended mission, the external auditor functions as an independent agent for a negotiated fee, and hence has a certain degree of independence inherent in that detached status.

The internal auditor, on the other hand, is an employee of the organization with a major mission of serving that organization in a variety of ways. The services rendered pertain to the effectiveness of both internal procedures and the related operations. The service has to do with all kinds of internal activities and interprets effectiveness to include both efficiency and profitability. The internal auditor has no direct responsibility to third parties such as creditors, investors, or government. Moreover, being an employee of the organization unavoidably restricts the level of independence as compared to that enjoyed by the external auditor. At the same time, however, it should be recognized that the two missions are not isolated from each other. Instead, as each audit group carries out its primary mission, there are intermediate and secondary concerns which involve common interests. In both cases there is an underlying need for sound internal control and the related policies, procedures, and day to day activities. Likewise in both cases, that internal control is viewed as a means to the end of carrying out the primary mission.

Historical Development

If we wish to adequately understand contemporary issues, it is always helpful to look back at historical developments and to review the manner in which the currently existing situation emerged. It, therefore, seems appropriate that we follow that approach for internal auditing. In doing this, we recognize that how far one goes back into history is bound to be arbitrary. Moreover, the applicability of the study of history always has its limitations because of changing environmental conditions. We also recognize that all organizations and all internal audit groups are different and that each situation involves a response to its own environment in a distinctive manner. Nevertheless, it can still be useful to review the past to assist in understanding the present and for projecting what may lie ahead.

In the case of internal auditing, we know that internal auditing as a concept has existed as early as there have been substantive human relationships. Conscientious people have always been concerned with the extent of compliance with instructions, the reliability of information, and the effectiveness of results—whether carried out as a part of regular operational responsibilities or by various subordinates, however they might be designated. We select 1941, however, as our first historical reference point. We do this on the personal side because this was the year that the author completed his doctoral research under Professor Roy B. Kester at Columbia University covering the nature and scope of internal auditing, and which became the basis for the first major book in the field, **Internal Auditing, Principles and Practice,** which was published by The Ronald Press Company. The year 1941 is, however, more noteworthy because it was the year in which The Institute of Internal Auditors was founded—an event in which the author was privileged to be an active participant.

In 1941 there were a number of internal auditing departments, but they existed only in a small proportion of the organizations that had need for such services. These internal audit groups concentrated on compliance with lower level accounting and operational procedures, protection of assets, and detection of fraud. There was at that time, however, an increasing awareness of the growing size and complexity of all kinds of operations by business, government, and other types of organizations. The external auditor was also becoming increasingly concerned with those same problems, and especially how they impinged upon the responsibilities of that profession. There was in total a growing recognition that internal auditing departments could make an important contribution to coping with the emerging complexities.

The response to the foregoing was a new wave of strengthening existing internal auditing departments and creating new internal auditing departments when such audit groups did not already exist. External auditors in many cases were the parties recommending new internal auditing departments and/or being called in to help work out the needed expansion of audit effort in their client companies. In many situations, the internal audit personnel were supplied or recruited by external auditors, and then trained and guided by them. It was inevitable, therefore, that internal auditing efforts would be very supportive of external auditor needs and relatively closely coordinated to assure the greater reliability of financial statements. This meant that internal auditing efforts were especially directed to accounting procedures and related lower level compliance, as previously indicated, rather than to broader improvement, operational effectiveness, and greater profitability. The existing internal auditing departments also typically reported to one of the lower ranking financial executives—more often to the officer responsible for accounting activities. This was the typical situation, although the writer's research preceding the completion of the aforementioned book showed that some business corporations had very progressive and sophisticated internal auditing departments.

Formation of The Institute of Internal Auditors

As previously mentioned, 1941 was also the year when a group of forward-looking internal auditors became discontented with the orientation of existing professional associations and decided that a new professional organization should be established and devoted exclusively to the professional interests of internal auditors. This decision marked the creation of The Institute of Internal Auditors with twenty-four charter members. John B. Thurston, the head of the internal auditing department at North American Company—a large public utility—was the moving force, and he became the new Institute's first president. Later, Thurston also wrote a book on internal auditing: *Basic Internal Auditing Principles and Techniques,* published by International Textbook Company.

During the years following 1941—and especially following World War II—a number of interrelated forces were at work. There was first of all a continuing expansion of the size and complexity of organizations—business corporations, governmental bodies, and philanthropic organizations. Business corporations were also becoming increasingly diversified and extended geographically—including more and more international operations. As a result, there were additional concerns of both management and external auditors and a related effort to further expand and upgrade internal auditing groups. Also management became increasingly aware of the desirability of getting more benefits from the very substantial amounts of money expended to maintain internal auditors, and therefore, was motivated to use them in connection with broader operational problems to which these internal auditors were concurrently being exposed.

Operational Auditing Introduced

At the same time, internal auditors were increasingly aware of the further opportunities to go beyond the narrower protective role and to make more substantial and dynamic contributions to management welfare. And when management responded favorably to the extension of the services rendered there was all the more incentive for internal auditors to move even more aggressively. This new emphasis of internal auditors, over and above their more traditional financial auditing role, came to be known as "operational auditing." As a result, internal auditing broadened in professional scope and attracted individuals of greater capabilities. The higher level contribution of internal auditors also brought with it new visibility with management, resulting in better organizational status and higher monetary rewards.

In most situations, the expansion into operational auditing was built on and integrated with the so-called more traditional financial auditing. In other situations the enthusiasm for the more dynamic operational auditing resulted in some reduction or contraction of the earlier financial auditing. In the latter cases, there was some weakening of the ties to the external auditors and a resulting reduction in the reliance placed on internal audit work. While again there were all types of situations, on average internal auditing came to focus on organizational effectiveness in terms of improved operational results and greater profitability. An understanding of this expanded role of the internal auditor is very important as we appraise the contemporary scene, with its new pressures, and the resulting alternative directions in which internal auditing may move.

Other Developments

The developments over the years since 1941 have also included some situations where the services provided by the internal audit department have been expanded to go beyond the needs of officers of the operating organization and to also be directed toward the needs of the board of directors. In some cases, there were new dotted-line-type organizational relationships to the board of directors and, in a few cases, solid-line-type reporting responsibility. (Dotted line describes those situations where there are partial responsibilities and solid line refers to situations where there is primary administrative responsibility.) The latter situation has more often come to pass in the banking and insurance industries where the handling of cash and negotiable securities, with the related higher level of risk exposure, has resulted in increased concerns of boards of directors. Industry wide, however, the relationship of the internal audit group to the board has been less structured and often not clearly defined.

A final significant aspect of the thirty-five plus years which have elapsed since 1941 pertains to the growth of the professional association founded in that earlier year. This association—The Institute of Internal Auditors—over the ensuing years has grown from its initial charter group of 24 to an international organization with over 16,000 members, with over 130 chapters, and with a headquarters staff of some 55 persons. The activities of The Institute have come to include a substantial research program, the development and administration of educational seminars, the publication of a professional journal and major books and monographs, the development of an effective interface with other parties interested in internal auditing, formulation of professional standards, a certification program (Certified Internal Auditor), and a wide range of other membership services. The composite result has been an integral part of the expanding professional status of internal auditing.*

The Contemporary Scene

The internal auditing profession has developed in more recent years to a level where it serves a wide range of organizational needs. The services rendered, as we have seen, typically cover both the financial and operational dimensions of organizational activities. The services rendered can, as we also have seen, be viewed as covering both protective needs and all kinds of improvement. This total range is outlined more specifically in the earlier mentioned **Statement of Responsibilities of Internal Auditors,** as follows:

> The objective of internal auditing is to assist all members of management in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations and pertinent comments concerning the activities reviewed. Internal auditors are concerned with any phase of business activity in which they may be of service to management. This involves going beyond the accounting and financial records to obtain a full understanding of the operations under review. The attainment of this overall objective involves such activities as:
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> - Reviewing and appraising the soundness, adequacy, and application of accounting, financial, and other operating controls, and promoting effective control at reasonable cost
> - Ascertaining the extent of compliance with established policies, plans, and procedures
> - Ascertaining the extent to which company assets are accounted for and safeguarded from losses of all kinds
> - Ascertaining the reliability of management data developed within the organization
> - Appraising the quality of performance in carrying out assigned responsibilities
> - Recommending operating improvements.

The above portion of the Statement of Responsibilities is a helpful elaboration of the internal auditor's role in several ways. In the first sentence it describes very concisely how the internal auditor discharges his or her responsi-

* The history of the Institute of Internal Auditors is presented in further detail in "Foundations for Unlimited Horizons—The Institute of Internal Auditors 1941-1976" written by the author of this paper, and published by The Institute of Internal Auditors.

bilities through providing analysis, appraisals, recommendations and pertinent comments covering the activities reviewed.

The six types of activities cited are also helpful because of the more precise identification of those that are primarily protective in nature (the second, third, and fourth) and those that are primarily directed to further improvement (the first, fifth, and sixth). In actual practice, the recommendations for improvement are developed to a major extent by building upon the more routine protective type activities. Both types of service are very important but it is the development of improvements that has demonstrated the most dynamic professional potentials for internal auditors.

In the previously mentioned Standards, the work of the internal auditor is covered by standards and guidelines in five areas as follows:

1. The independence of the internal auditing department from the activities audited, and the objectivity of internal auditors.
2. The proficiency of internal auditors and the professional care they should exercise.
3. The scope of internal auditing work.
4. The performance of internal auditing assignments.
5. The management of the internal auditing department.

Of special interest for educators is the portion of the second area of the Standards that deals with the knowledge, skills, and disciplines needed by internal auditors. Included here are the statements that:

- Proficiency in accounting principles and techniques is required of auditors who work extensively with financial records and reports.
- An understanding of management principles is required to recognize and evaluate materiality and significance of deviations from good business practice.
- An appreciation is required of the fundamentals of such subjects as accounting, economics, commercial law, taxation, finance, quantitative methods, and computerized information systems.

This broad coverage of required qualifications springs from the fact that the internal auditor is reviewing all types of organizational activities. It does, however, complicate the problem of where in the undergraduate and graduate business schools the responsibility for education of internal auditors should be centered.

The Changing Contemporary Situation

In more recent years, there have been a number of important developments which impact directly and indirectly on both business organizations and the independent public accountants who serve them. In the case of the business organization, the impact bears on both the management group responsible for operations and the board of directors to whom the operational group is responsible. These impacts in turn flow through to a considerable extent to the internal auditors in those same organizations. The underlying developments have created new pressures which bear importantly on the continuing roles and responsibilities of all of the aforementioned parties of interest.

The new developments can be viewed in the most general terms as due to new expectations of the total society pertaining to the quality of life. In more specific terms, the new expectations run to the protection of the physical environment, the conservation of natural resources, elimination of poverty, providing greater equal opportunity to people, the satisfaction of higher level human needs, and higher standards of morality. These expectations have always existed over time, but the current situation is characterized by an acceleration of these expectations, with a related demand for more immediate and more substantive corrective action. These new expectations have increasingly focused on business corporations, because of their relatively greater visibility, resources, and power. At the same time, individual instances of deficiencies of corporate conduct in various areas of corporate activity have fanned the flames of the new demands for corrective action.

All of these pressures have combined to cause a rising dissatisfaction with business organizations and those responsible for their operations, plus a substantial loss of confidence in the integrity and trustworthiness of business leaders. The pressures have been exerted in a number of ways. In the case of corporate management, there is the new emphasis on adhering to higher standards of conduct, better accounting policies, and for more comprehensive and more effective systems of internal control. For boards of directors there are pressures for greater involvement in corporate affairs, a deeper sense of both shareholder and social responsibility, and a greater use of audit committees. And in the public accounting area, there are pressures for greater independence and a higher and more definitive level of responsibility. The aroused public opinion has been expressed principally through demands for new legislation and greater governmental regulation and control.

The result of all of the various new pressures just described is to some extent to further involve the internal auditor. With the internal auditor's traditional focus on compliance and internal control, it is natural that all parties of interest tend to see the internal auditing group as a useful contributor to the solution of existing problems, and more specifically as a helpful ally in the accomplishment of their own particular objectives. The question thereby posed for the internal auditor is how to respond to the new greater needs, and with a further question as to what the priorities should be in serving the particular needs of the various parties of interest. The latter question may of course be taken out of the internal auditor's hands by the decisions of higher authority, including specific legislation. At the same time, however, internal auditors are endeavoring to make their own appraisals of what is best in terms of their own self-interest and the needs of the larger society. This requires reconciliation and resolution of any existing conflicts, and then help in a constructive way to shape the evolving pressures and demands by higher authority. All of this raises questions of what is the best ongoing role and what are the related responsibilities for the internal auditor now and in the years ahead? What are the alternatives and how do they impinge both upon the responsibilities of the other parties of interest and the total social welfare? And then, in the light of those choices, what should be the nature and scope of internal auditing practice for implementing the selected role over the foreseeable future?

Whither Internal Auditing

There are many ways that internal auditors might respond to the new pressures on business organizations and independent public accountants. In all of the various alternatives there is, however, a central issue of what priorities should be given to services to corporate management versus services to the board of directors. In this connection there are various sets of arrangements which could in some way separate or integrate these priorities. These alternative arrangements extend from the extreme of solely serving corporate management to that of solely serving the board, with various types of intermediate combinations. We propose to evaluate the two extreme alternatives and then to appraise the merits of various types of combined orientation. In that way we can best understand the trade-offs involved as one moves from one extreme to the other, and perhaps be in a better position to find the proper balance.

Let us begin with the possibility that the internal audit group is to be exclusively dedicated to the service of the operational organization and its corporate management. The merits of such an arrangement are that the corporate management can then use the internal audit group to fully serve its own managerial needs, free from any outside restrictions. Presumably, under such conditions the emphasis of internal auditing would be primarily on operational auditing, but plus whatever financial auditing activities the corporate management believes appropriate in discharging its own responsibilities to the board. One could perhaps argue that this arrangement would best exploit the already proven capabilities of internal auditors to achieve maximum profitability of the operating organization. The internal auditor would at the same time find life a bit simpler in that reporting allegiance would be only to the corporate management. Under this arrangement, however, the board of directors and its audit committee would presumably have to depend more on the independent public accountant to take care of their own needs, or alternatively create a new audit group to provide some of the needed services.

Now let us take the other extreme and assume that the existing internal audit group is exclusively responsible to the board of directors—most likely via its audit committee. Now the internal audit department would emphasize protecting the responsibilities of the board and would presumably concentrate on the more traditional objectives of compliance, protection, and integrity. To the extent that the board extended its operational involvement, it would also have the seasoned internal audit group to assist it in those endeavors. Under this arrangement, however, the role of the internal auditor would appear more likely to identify with that of the external auditor. There might also be some conflict between the work of the internal auditor and the operating organization because the internal auditor, to a considerable extent, would be checking on corporate management for the account of the audit committee. Presumably the internal auditor would take on a more powerful protective role, but that could be directly or indirectly undermining, or even giving up, the present major stake in operational auditing. It is also most likely—if not inevitable—that corporate management would seek to obtain operational auditing type services from another organizational component, or that it would create an entirely new group to do the in-house operationally oriented internal auditing. That new audit group would likely move into the vacuum created by the partial or complete withdrawal of internal auditors from the operational area.

Exploring the Middle Ground

In between the two alternatives of exclusive service to corporate officers or the audit committee is a spectrum of intermediate possibilities. We will, however, focus only on three alternatives: one of primary responsibility to the corporate management with a defined secondary responsibility to the audit committee; one of primary responsibility to the audit committee with a defined secondary responsibility to corporate management; and a third one involving equal responsibility to the two users of audit services. In this range of alternatives, we use primary responsibility in terms of the conventional solid-line type of relationship, and secondary responsibility as the conventional dotted-line relationship. The solid line then indicates administrative control, but subject to dotted-line types of responsibility to others that should be specifically defined. When there are two solid lines, we have the unusual organizational arrangement where responsibility and administrative direction are shared equally by the two recipients on a partnership basis.

What are the merits and disadvantages of these three types of organizational arrangements? Under the first named alternative—the solid line to corporate management and the dotted line to the audit committee—the internal audit role to corporate management would stay much the same as now presently exists. The dotted line responsibility to the audit committee would presumably include periodic reporting—both in writing and in person—and immediate access for each party to the other as deemed necessary. The responsibilities as defined would probably state particular types and levels of required disclosure. The advantages are that each party of interest might be able to gain satisfaction of its needs for service without restricting the control needed by corporate management for achieving effective operations. The disadvantages are that there might be some conflict of interest between the management and the board, and that the board might then feel that it was not getting enough protective service from the internal audit group to satisfy its expanding needs.

The reverse type of organizational arrangement—a solid line to the board and a dotted line to corporate management—would of course put the audit committee in the position of top control and thus more fully satisfy governmental pressures for very strong safeguards. It would, however, have the disadvantage of tending to restrict corporate management in its now existing use of internal auditors in the areas of operational auditing. There could also be some hostility generated between the corporate management and the board. The benefits to the internal auditor would, of course, be retention of ties to both client groups, and therefore a total service role, but it would at the same time pose questions as to whether both audit roles would be adequately fulfilled. Again, corporate management might feel the need for a new audit group which it could more effectively control.

The third alternative—the solid line to both parties of interest—appears on the surface to be attractive because it asserts full service of the internal auditor to both parties of interest. The major problem here, however, is whether such a type of organizational arrangement is sound, or even realistic. Can an internal auditing group function under two administrators? Admittedly, there are some situations where this has been tried with reasonable success. The project team, with the dual responsibilities of the member to the project manager and to the department from which the member has been assigned, is one example. However, in such a situation there is a higher level organizational authority which is available to directly or indirectly resolve any major conflict. It is doubtful whether such higher level arbiter exists as between corporate management and the board in any really practical sense. Hence, even though the idea of equal joint responsibility may sound like a good solution, there is considerable doubt whether it is satisfactory for the parties of interest, including the internal auditor. We reach this conclusion even though such equal responsibility may have been made to work in isolated situations through an extraordinarily cordial relationship between the chief executive officer and the chairman of the board.

Is there an Answer?

What is the answer? Quite clearly, we have a number of trade-offs which can never be resolved in a manner that will be fully satisfactory to all parties of interest. There is also the continuing question of how the respective roles and responsibilities of corporate management and the board of directors are going to evolve in the future. On balance, it would appear—at least to this author—that boards of directors cannot effectively take over the role of corporate management. If they do, they will need full-time people of the caliber of the now existing corporate management. In such a situation it could well be that the present top level corporate officers would become the board members and simply have new titles. In that case, however, we would then need a new group to monitor the board in the discharge of their greater operational responsibilities —that is, a kind of super board—in which case, we would be back about where we had started. Possibly at this point, government might somehow take on the super board role, but based on historical performance, greater governmental control has brought with it new problems which tend to be even more difficult to solve than those previously existing. Hence, that does not seem to be a good answer.

If the relationships stay much as they are now, but with more enlightened roles on the part of both corporate management and boards of directors, we would, in this writer's opinion, tend toward the internal audit department having a solid line responsibility to corporate management and a defined dotted line to the board of directors—via the audit committee. In the case of corporate management, it would then seem to be essential for the internal auditor to have vice president status to demonstrate management commitment and to assure needed independence in carrying out an effective internal auditing role. The internal auditor would then ideally report to the chief executive officer (CEO). However, the CEO might not have adequate time to provide the needed direction to the internal auditor, and in such a situation the reporting responsibility might well run to a senior vice president reporting directly to the CEO. Under either of these reporting arrangements, the internal auditor should work closely with the external auditor, and together they should work closely with the audit committee. In these circumstances, there would necessarily be a close partnership relationship between the chief executive officer, the chief financial officer, the chairman of the audit committee, and the chairman of the board.

The advocacy of the arrangement just described in no way denies that there are serious obstacles to making this arrangement work satisfactorily. It assumes, first of all, that the cooperative effort outlined above could be generated and sustained. The case for it is that there is, in fact, a basic common interest on the part of all participants for a well run, effective and profitable corporate enterprise. When this common interest is sufficiently well understood, there can be a sound basis for agreement and cooperative effort. The advocacy of the abovementioned reporting arrangement also carries with it the major assumption that the internal auditor has, or can develop, the needed capabilities to adequately serve all the parties of interest. Proper organizational status is, of course, important, but needed also is a sufficiently high level of technical competence, an understanding of the high level management and related policy issues which are involved, and last but not least, the personal qualifications to be able to work effectively with high ranking persons. To develop these greater capabilities is indeed an awesome challenge to internal auditors, although the record thus far engenders confidence that it can be done. However, internal auditors will have to make proper plans and then implement them effectively.

Future Practice Directions

If the organizational arrangement for the internal auditor just described is accepted—that is, primary responsibility to corporate management and defined secondary responsibility to the board of directors—what will the impact be on the nature and scope of internal auditing practice as internal auditors strive to effectively discharge this combined service role? From the author's own perspective, the professional internal auditing practice will involve four key areas. First, the internal auditor will continue to be the leader in the appraisal of the adequacy and effectiveness of systems of internal control covering all areas of corporate activity. These systems of internal control must now, however, be broader in scope to cover the areas of social concern earlier described. The internal auditor will, at the same time, properly play an active role in the required documentation of the adequacy of internal control to comply with various types of new legislation. This "control" role of the internal auditor is, in essence, an expanded and enriched version of the role which has in recent years been one of the major areas of service.

Secondly, the internal auditor will continue to build upon the basic control role to provide supplementary "operational auditing" services pertaining to managerial effectiveness and corporate profitability. The exposure to operations provided through the analysis and appraisal of control is, as it has always been, a most useful foundation for understanding and evaluating effective operational performance. And quite clearly, the previously described expanded control role will provide the basis for a similarly expanded contribution in the area of promoting operational effectiveness. This particular service is especially important when one considers that the current major emphasis by government and society on protection tends to inhibit managerial risk taking and related entrepreneurial operational actions upon which increased productivity and the welfare of society ultimately depend.

Thirdly, the internal auditor will certainly move into a new, higher level of truly effective service to boards of directors via their audit committees. It is assumed—based upon the previous analysis—that boards of directors and audit committees continue to involve the part-time services of qualified and dedicated persons. Under these conditions, audit committees may have small staffs, but in carrying out their roles, will depend primarily on their interface with corporate management and information obtained from both the internal and external audit groups. Here, as previously noted, they will need to get certain periodic reports and have the opportunity to supplement these reports with questions and face to face discussions. Audit committees will not necessarily administer internal audit groups, but they need to be cognizant of how to support them and how to best assure receiving adequate information about corporate operations. This needed information then becomes the basis for best assuring effective and profitable results in accordance with proper legal and moral standards. To help provide that kind of service would surely be a newly expanded role of internal auditors.

Fourthly, it seems to be inevitable that there will be a still more effective partnership relationship of the internal auditor with the external auditor. Here the often older relationship of superior and subordinate will be replaced increasingly by a new partnership of professional equals with mutual respect for professional competence and a common interest in service to the larger corporate and social welfare. Clearly, the different primary mission of the external auditor will still require the right of supplementary review and appraisal of the work of the internal auditor. But the two audit groups can at the same time exploit their legitimate common interests by advance planning, which can then be backed up by day-to-day liaison and cooperation to better insure the most effective, as well as the most economical, total audit effort. A forthcoming research study by The Institute of Internal Auditors covering the relations of the internal and external auditor will examine in further detail these cooperative efforts. But we can here recognize the indicated partnership directions and the major potentials for serving the needs of all parties of interest—corporate management, boards of directors, government, and the larger total society.

Summary and Conclusions

In some forty years we have seen internal auditing emerge from a relatively underdeveloped professional status to one of major importance in terms of its size and level of contribution. It has broadened its role from that of predominantly compliance and narrower financial auditing to include a major commitment to operational auditing. During this period of time, a professional association was formed and reached substantial stature. At the same time, a comprehensive literature has been developed supported by sound research. While internal auditing activities have always been, to some extent, related to those of the external auditor, these relationships have been weakened partially by the movement of internal auditors into the broader operational auditing. But over the years, internal auditing departments have grown and have commanded increasing strength and support by corporate management, external auditors, and by boards of directors.

The new developments of our contemporary age, emerging principally from the accelerated new expectations of society, have put new pressures on corporate organizations, their boards of directors, and the independent external auditors. There is a general demand for higher standards of integrity and responsibility for socially oriented action. There is, at the same time, the focus on the need for more effective systems of internal control. Since the internal auditor is importantly concerned with the latter area, there is a new interest in the internal auditor's role in helping to satisfy the newly expanded needs. These developments have created special problems for the internal auditor in determining how best to provide internal audit services, and with what priorities. At the same time these problems, as is true for all problems, bring with them great opportunities.

As society proceeds to seek ways and means of better assuring the accomplishment of its newly expanding objectives, principally through legislation or other types of governmental action, there is the ever critical need to move in such a way as best utilizes the capabilities of the various parties of interest—corporate management, boards of directors, the independent public accountants, and last but not least, the internal auditors. It is important to avoid panic type actions which could take the form of hasty legislation and related restrictions on key participants, which would then prevent them from making needed contributions. It is especially important not to penalize the majority by actions to get protection from the relatively few offenders. Important also is the need to avoid restrictions which could choke enterpreneurial risk taking and managerial motivation which are such a basic requirement for the productivity of business and the ultimate contribution to social welfare. It is, indeed, a time for thoughtful and soundly determined action.

In the situation just described, internal auditors stand in a particularly strategic position. Possessing, as they do, special technical competence in the basic areas of internal control, and having been further indoctrinated in the broader areas of effective managerial results, they are especially well equipped to make a major contribution. The danger, however, is that their role might be too narrowly defined to serve exclusively the needs of groups which seek protection as their key objective. There is a need for all parties of interest to better understand the breadth of the services which can be provided by internal auditors and to assure broader utilization of those services. In this connection, internal auditors also have a responsibility to help develop that needed understanding—both in their own self-interest and in the broader social interest. At the same time, internal auditors must take major steps to prepare themselves to adequately discharge the greater range and higher levels of service which appear to be potentially probable.

In total, this means new major opportunities for internal auditors in the way of further professional growth and development. It has been said that the time for the internal auditor has come. And others have said that internal auditing will be a major growth area of the eighties. If, then, the time has come for internal auditors, it is hoped that they will do everything possible to develop further capabilities to take advantage of the expanding opportunities. In all of their endeavors, the internal auditors have a sound foundation in history on which to build, but they will need the understanding and support of all parties of interest.