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# Who is responsible to the audit committee?

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reviewing the work of the committee. It is also desirable that these audit committee members be independent directors, not part of the management team. The audit committee is going to be dependent on the internal auditor, in any event, for much of the information it seeks. The internal auditor should report to the committee as well as to the CEO. The external auditor will also assist the audit committee in overseeing internal controls.

The last major point is that an audit committee report should be presented at every board meeting. Its chairman should report the current status of internal controls. If nothing meaningful has come to the committee's attention since the last board meeting, it may have no report. In this fashion, board members not on the audit committee can carry out their monitoring responsibilities required by the Foreign Corrupt Practices Act.

*A. A. Sommer, Jr., a partner in the Washington, D.C. law firm of Wilmer, Cutler & Pickering, was Commissioner of the Securities and Exchange Commission from 1973 to 1976.*

# Who Is Responsible to the Audit Committee?

by W. DONALD GEORGEN/Vice Chairman, Board of Directors, Touche Ross

MEA

The primary responsibility for developing, implementing, and monitoring a system of internal controls lies with management. Many companies have formed an internal audit function to act as a management surrogate in monitoring compliance. In other words, they have created a vehicle to see if their rules are being followed.

That is looking at it from the management level. When you are looking at it from the board level, in the broadest corporate sense, the internal audit function becomes part of the internal control system. Then, who should be the surrogate of the audit committee or the board? Mr. Sommer would say primarily the internal auditor, and I think we might have a small disagreement on that particular point. We at Touche Ross say the principal surrogate for the audit committee should be the external auditor. He should be the one that gathers and evaluates evidence of what the company and the company's internal auditor have done. And the external auditor should be the one to present this evidence to the audit committee—with an evaluation and appropriate recommendations.

I like to draw the analogy that the external auditor serves as the diagnostician. You go to a doctor, who performs an examination, and he says, I think you should come in for some elective surgery. And he offers the reasons for it. But it is you who evaluate the reasons—you may even get a different opinion—and it is you who make the decision. In the area of internal control, it is the board which makes the final decision.

At Touche Ross, we also believe that the external auditor has a responsibility to play more than a passive role in evaluating internal controls. That is, when the external auditor comes before the audit committee, he needs to do more than simply respond to questions: yes, no, maybe, never. The external auditor has the responsibility to assess whether or not the audit committee is evaluating the basic systems and has been informed about the primary areas of risk and what the basic controls are to protect against those risks.

Now, the fact that the audit committee should look to the external auditor as the primary surrogate does not preclude it from also looking to the internal auditor—or any other source that the committee believes can provide facts that would help in making its evaluation. The same analogy holds true for the external auditor. Although he is primarily responsible to the audit committee, he should also have a working relationship with management on a day-to-day basis.

I make these points in response to the furor over some of the remarks by SEC Chairman Harold Williams, in which he discussed to whom the internal auditor should be responsible. I think that, in substance, I am in accord with what Mr. Sommer has discussed here.

To review, the internal auditor is primarily responsible to management; it is the vehicle management uses to evaluate systems and check for compliance. Whereas the external auditor is primarily responsible to the board or to the audit committee. In the final analysis, however, this distinction isn't really that important, since the audit committee should have access to internal audit whenever it desires, and management should always have free and open contact with the external auditor.