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Members in Internal Audit, October 1997

American Institute of Certified Public Accountants (AICPA)

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Highlights

Industry members are encouraged to participate in the **CPA Vision Project's Future Forums**. See the calendar at the www.cpavision.org Web site for forum dates or call your state society for more information.

Countdown to 2000: Y2k-savvy CPAs Can Play a Major Role in Business-Readiness

The year 2000 computer problem can be explained so easily that a child can understand it. That simplicity masks the complexity and enormity of the problem for most of us. For example, many people who understand the problem at its basic level do not know that:

- The y2k (year 2000) problem is not just a mainframe COBOL problem.
- The y2k problem is not just a software problem.
- The y2k problem is not just a Fortune 500 problem.

The y2k problem shows up in many types of hardware: mainframes, client/server, and PCs. It occurs in software: packaged software and custom-designed. It appears in embedded systems: building security, climate control, manufacturing process control, appliances, telephone systems, and so on. The y2k problem is pervasive: just about every business, large and small, will be affected.

The Gartner Group's $300 to $600 billion estimate to fix the problem globally is widely quoted. Bruce Hall, research director at Gartner Group, estimates that half of all organizations will not be able to update their systems in time for the year 2000. Thirty percent of mission-critical applications will not be ready, he predicts. Some companies that

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New Joint Benchmark Study Benefit Unlocks Vault of Best Practices

It will now be easier for companies in the AICPA/The Hackett Group (THG) joint benchmark study to steal the learning curves of the benchmark's top performers. They're getting the keys to the bank - access to THG's Databank of best practices.

The Databank is a new Web site accessing THG's library of best practices drawn from the study's top performers. For each finance process in the benchmark, there are best practices descriptions, reengineered process flows, hints for quick fixes and up-to-date performance metrics.

The Databank is a benefit available only to companies that have completed the benchmark study. "For the first time, participants will have the opportunity to access The Hackett Group's library of best practices, giving them the opportunity to understand the first-quartile characteristics of each finance process used by world-class companies today," according to Christine Gattenio, a vice president with THG who also heads its benchmark division.

The AICPA/THG benchmark study provides details on how companies can improve the productivity of their financial operations by looking at 29 processes drawn from three major categories. The AICPA and THG have been providing this joint study to AICPA members since 1992. A new Small Company Benchmark Study will soon be launched to more fully address the benchmarking needs of companies with revenues of less than $100 million, Gattenio added.

The site can be reached at www.thgi.com/aicpa and is accessible by password only to companies that have completed the THG/AICPA joint benchmark study. Password registration is done online. For more information about the Databank site, or to participate in the benchmark study, contact Hadassah Baum, AICPA technical manager.

212/596-6019

THE BROADENING ROLE OF INTERNAL CONTROL

Issues Paper 15, *Corporate Governance: The Role of Internal Control*, published by The Society of Management Accountants of Canada, provides an in-depth look at internal control, noting implications for management accountants.

Meaning of Internal Control

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission published *Internal Control—Integrated Framework* (the *COSO Report*). The Report's definition of internal control is generally accepted in the U.S., and is increasingly referred to in other countries. The *COSO Report* correctly sees internal control in a more positive and balanced light than simply the detection or prevention of fraud or errors.

Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations;
- reliability of financial reporting; and
- compliance with applicable laws and regulations.

Approach to Internal Control

A board that accepts responsibility for internal control should:

- agree on a definition of internal control;
- decide who has to see that control systems are developed, maintained effectively, monitored, and reported on at regular intervals to the board or to a committee by appropriate parties; and
- decide what should be disclosed to stakeholders who inquire about internal controls.

Reporting to the Board on Internal Control

External auditors normally focus on control related to financial reporting. The board cannot therefore expect to receive from them comments on controls over:

- effectiveness and efficiency of operations; and
- compliance with applicable laws and regulations (except for those giving rise to financial exposure, such as environmental legislation).

The board may receive comments on controls over these two matters from internal auditors. The increased responsibility of directors and management for internal control monitoring and reporting has changed the relationship between the board and senior management. Management is responsible for implementing proper internal control procedures and monitoring compliance; the board is responsible for ensuring management has done this effectively. It is important that directors understand their role.

Communication Between Senior Management and Staff

Internal controls need to be continuously updated to keep pace with the changes in organizational structure and information systems. They should be designed to support the organization in the attainment of specific goals and objectives.

Many organizations are being more open with staff and are sharing not only the organization's mission and/or vision with employees, but also summaries of the operating plans.

Organizations have developed written codes of conduct for all employees, not just the board and senior management. These codes cover the organization's attitude towards internal control and relationships with employees, customers and suppliers.

Evaluations of Employees Responsible for Internal Control

Organizations have amended job descriptions for staff (and management) to incorporate expectations other than those related to technical competence. Examples of other competency expectations being added to job descriptions are:

- leadership effectiveness;
- commitment to the organization's objectives;
- creativity and innovation;
- team effectiveness; and
- communication effectiveness.

Senior Management Evaluation of Internal Controls

The COSO self-assessment model uses the following as a framework for evaluating internal controls:

- all major activities of the organization (e.g., purchasing, product sales, human resources, strategic planning, risk assessment);
- control objectives related to each activity;
- risk(s) if each control objective is not met; and
- control activities which will mitigate each risk.

This information should be obtained with the help of the employee group. Then the effectiveness of each control activity should be assessed and action plans developed to strengthen or establish an appropriate control.

Implications for Management Accountants

Management accountants are particularly equipped to implement and maintain these systems, and the use of sophisticated analysis is becoming increasingly important to internal control systems.

Corporate Governance: The Role of Internal Control (Issues Paper #15), is available individually from the AICPA (No. 028970CLB10) or as part of *The New Finance: A Handbook of Business Management* (No. 028900CLB10).

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Send the completed request form to: American Institute of CPAs, Center for Excellence in Financial Management, E. Limandri, 1211 Avenue of the Americas, New York, NY 10036-8755

*continued from page F1—**Y2K CPAs***

ignore the problem will face lawsuits, bankruptcy or go out of business.[1]

Exactly what is the problem? Because storage costs were very expensive, the century portion of a date field was never stored in the computer. It was always assumed to be "19". Only the last two digits of the year were stored. For example, "83" was assumed to be 1983. You can deduce what will happen when the clock rolls over on December 31, 1999. The computer will think it is 1/1/1900 (see April 1997 *CPA Letter* insert).

Many companies' year 2000 woes have already started:

- Perfectly good corned beef inventory was destroyed by a Marks and Spencer computer because the computer thought the corned beef was nearly a hundred years old[2]. Five-year forecasting systems started gasping early in 1996.
- A state prison computer ordered an early release of some inmates because it thought they had completed their sentences.[3] They did not get out—guards overrode the system.
- Credit cards with "00" expiration dates have been rejected by merchants' card readers.

As you can see, we do not have until 1999 to deal with this problem. Mid and large-sized businesses that have not started their year 2000 projects by mid-1997 may not succeed in converting their systems in time. Small businesses should not procrastinate, either. One of the first widespread year 2000 issues for many businesses will be their ability to take credit cards with an "00" expiration date.

Not only must the credit card companies and the member banks become year 2000 compliant, the merchants' card readers must be able to recognize "00" as a valid date or the sale will not be approved or processed. Many merchants are unaware that there are or could be problems with the equipment.

CPAs who are knowledgeable about the y2k problem can give their employers a "heads-up" warning about their credit card processing equipment. CPAs can advise companies that take credit cards to check their card readers immediately. Equipment that is not found to be compliant must replaced or updated with a new hardware or software version. The credit card equipment vendor can be called to find out the details of becoming compliant. When you consider that the penalty for non-compliance could be as serious as losing a sale, a CPA's warning could go a long way in enhancing employer or customer relations.

For companies that have not started their year 2000 efforts yet, expert Peter de Jager offers some advice. Imagine being in a car traveling 100 mph heading toward a brick wall. What is the best approach: to engage in extended conversations about how long it will take you to stop, or to hit the brakes now?[4] CPAs have a great opportunity to help their employers avoid any year 2000 crashes.

[1] Amy Malloy, "Beat the Clock!," Computerworld, January 6, 1997, page 67.

[2] Steven Levy and Katie Hafner, "The Day the World Shuts Down," Newsweek, June 2, 1997, page 53.

[3] Rick Telberg, "Start Worrying: The Year 2000 Bug Is For Real," Accounting Today, June 2-15, 1997, page 6.

[4] Jon Newberry, "Beat the Clock," ABA Journal, June 1997, page 49.