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# ARGOS plc

7 July 1992

Mr. Nigel Peace, Secretary  
Committee on the Financial Aspects of Corporate Governance  
P. O. Box 433  
Moorgate Place  
LONDON, EC2P 2BJ

Dear Mr. Peace:

I have received a copy of the Cadbury Draft Report dated 27 May 1992 from the internal management of Argos, Plc., and would like to offer the following comments.

As a professional internal auditor (with both certified and two advanced academic degrees on internal auditing, plus many years of practical experience in the field), I was somewhat dismayed at the lack of recognition, or importance attached to the role of my profession in this report. I cite the following as examples, purely for enlightenment:

a. In general, throughout the report incorrect reference is made to the generic term of 'auditors' as implying synonymous reference solely to the public auditing profession; it is not the only body performing this function.

b. Re: 4.29, 3rd Recommendation:

**"...if applicable, the head of internal audit should normally attend audit committee meetings...."**

I assume that the intent is that if there is a head of internal auditing present in the firm then they should attend the meeting; but as written it implies attendance is at the discretion of management when it should be a mandatory requirement of the role.

c. Re: 4.29, 4th Recommendation:

**"The Audit Committee should have the explicit authority to investigate any matters within its terms of reference, the resources...to do so...full access to information."**

Internal Auditing IS the investigative arm of the Audit Committee; if your recommendation on the composition of the committee being solely that of external non-executive directors is adopted, then it is all the more important to have an internal force familiar with the organization's practices etc., to ferret out queries.

d. Re: 4.31:

1. **"The function of internal audit is complementary to that of the outside auditors."**

In truth, it is not--beyond only the broadest definition of the word 'complementary' and definitely not an inferred supplement to external auditing. Internal auditing is an independent appraisal function established within an organisation to examine and evaluate its activities as a service to the organisation with the objective to assist its members in the effective discharge of their responsibilities, furnishing them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed. External auditors have the objective to express an independent expert's opinion as to the fairness of their clients' financial statements; thus restricting the scope of their reviews to financial records and the accounting areas; and only to matters which have a material effect on the business. Internal Auditors have a wider scope as they may review any records, any activity, and any areas in the organisation--this focus on operations expanding the scope of internal auditing far beyond that of the external auditor. It is true that our missions regarding internal control are supportive, but again to a marked difference as external auditors are concerned with internal accounting controls, internal auditing with the entire internal control system including those over accounting--with prime concern over the adequacy and effectiveness of them--which are only secondary to external auditing to the expression of their opinion. If the external auditor finds poor controls they make more substantive tests, where the internal auditor makes recommendations to improve them and follows up to see that the weaknesses are corrected; if the external auditor makes such recommendations, they are only of a secondary nature.

2. **"In large companies, the existence of effective internal audit arrangements is both an aid to management control and limits the amount of external audit work which is required."**

Internal audit 'arrangements'? A curious choice of words for such a key function within an organisation normally referred to as a 'department'.

While it is correctly inferred that effective internal auditing limits the need for extensive external auditing work, the statement oversimplifies this important action without clarification as to how or why. It is the reliance on the professional quality of the internal audit review and its findings which limits the need for more external auditing work--which can also cause further expansion of that audit in a quest for more information. As internal auditing examines operations in depth, there is no need to 'reinvent the wheel' by external auditing, provided that examination is thorough.

3. **"Audit Committees provide a natural link between the external and the internal auditors...."**

Incorrect. This implies catalytic action on the part of the committee to bring the two agents of auditing together which is false. One of the responsibilities of the head of internal auditing (according to the Institute of Internal Auditors' Standards of Professional Practice re: 550) is to '...coordinate internal and external audit efforts...' via periodic meetings, access to working papers, exchange of reports, and common understanding of techniques etc. Thus a striving for mutual cooperation should already be well in place and should occur regardless of the existence of an audit committee. It is of mutual benefit that the links be established; from the stand point of the organisation to limiting the duration of an external auditing review thus limiting the fees charged; from the external auditors point of view in obtaining information with which to plan the scope of their reviews.

4. **"...we regard it as good practice that heads of internal audit should have the same access to the chairman of the audit committee as the external auditor...."**

While the intent is understood, this is a statement almost bordering on irrelevance as any experienced head of internal audit in any firm with an audit committee would have already demanded this access in order to perform their job--without it they would be operating blind to the committee's needs and fail to provide the desired services..

These, then, are the elements of the report which read en masse--coupled with the appalling lack of reference to any part played in fraud detection/prevention by internal auditing--fail to give adequate importance to the role of internal auditing.

I do not find this too surprising as it tends to mirror the general lack of UK awareness of the true value of this resource. But what is disturbing is that this lack of awareness causes ignorance of a means to aid accomplishment of the central goal of the Cadbury Committee--universal acceptance of a Code of Best Practice for corporate behaviour.

Two of the elements within the general scope of internal auditing are monitoring the degree of compliance of the organisation with rules, regulations, policies, procedures, etc.; as well as its accomplishment of the corporate goals and objectives. If a firm subscribes to the Code, who better to monitor its daily progress towards achievement than an internal department which conducts operational reviews? This would certainly be more effective than awaiting an annual, or biennial, review by an outside body.

Sincerely yours,



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CHIEF OF INTERNAL AUDITING

ARGOS plc

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