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UPFRONT

Internal control and the Cadbury Committee

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Introduction

I am going to try to put the question of internal controls into context in the Cadbury Committee's work and findings. I am then going to describe the background, the point we reached, and then go on broadly to speculate about future developments generally.

The reasons for setting up the Cadbury Committee were stated in paragraph 2.1 of the Report itself. The sponsoring organizations – the Financial Reporting Council, the London Stock Exchange, and the accountancy profession – were concerned at the perceived low level of confidence both in financial reporting and in the inability of auditors to provide the safeguard which the users of company reports sought and expected. A number of companies, some of them large, had failed spectacularly within a rather short time after issuing audited accounts.

At its earliest meetings the committee realized that it could not address the general concerns without looking at various aspects of corporate governance and it adopted the terms of reference accordingly.

> To consider the following issues in relation to financial reporting and accountability, and to make recommendations on good practice:
>
> (a) The responsibility of executive and non-executive directors for reviewing and reporting on performance to shareholders and other financially interested parties; and the frequency, clarity and form in which information should be provided;
>
> (b) The case for audit committees of the board, including their composition and role;
>
> (c) The principal responsibilities of auditors and the extent and value of the audit;
>
> (c) The links between shareholders, boards and auditors;
>
> (e) Any other relevant matters.

The membership of the committee reflects the strong emphasis on accounting issues. Of its 11 members, five were either professional accountants or concerned with the accounting profession. The remainder were drawn from industry and "the City " broadly defined. The Department of Trade and Industry did not have a member on the committee as such, but indicated its general support for its work by providing an observer and the secretary.

It took the committee about a year from its appointment in May 1991 to produce a draft report for public comment, which attracted a great many comments and observations. These were taken fully into account and the final Report was published in December 1992. It produced a series of recommendations and a Code of Best Practice (see appendix).

The work of the committee attracted a great deal of public attention, and expectations were raised that it would tackle all aspects of corporate governance. In fact, it looked more broadly at corporate governance than perhaps its terms of reference suggested – for the practical reason that it felt it could not deal adequately with the issue of the flow of information from company to shareholders without looking at the process within the business and the control arrangements. This in turn led to a discussion of the operation of the board. The committee knew, of course, that extensive work was going on in the accounting profession, under the auspices of the Auditing Practices Board and the Accounting Standards Board, and it had no wish to duplicate their work. This meant that the Code has had to leave certain gaps which would be filled when agreement has finally been reached on the appropriate standards. The most difficult and intractable of these gaps concerns internal control and I shall return to this later.

Because of the volume of work being conducted in the accountancy profession itself, apart from one or two important exceptions, the committee veered away from technical accounting issues and concentrated instead on the system of corporate governance which it defined in paragraph 2.5 of the report in the following terms: "Corporate governance is the system by which companies are directed and controlled". It follows, therefore, that the aim of the committee was *systemic* improvement – though not a thorough going review of the entire system. Major issues remain unresolved, and some of these are mentioned at the end of this article.

Some have asked who the committee reported to. In the formal sense the report went to those who had set it up. In reality it was reporting to the professional and business worlds at large and the public. The committee had no statutory powers and the value of its work could only lie in the extent to which its findings met general approval. In the event – although there have been criticisms that the committee went too far, or that it did not go far enough – there seems to have been a general consensus that the result was sensible and workable. This is not wholly surprising since it went with the grain of thinking over the last decade: many echoes of its work can be seen in the Watkinson Report of 1973 (commissioned by the Confederation of British Industry), and PRO NED's (Pro Non-executive Directors) work in the early 1980s. Much of what it suggested, for instance in relation to audit committees, is similar in practice in the USA whose corporate governance system is nearer to that of the UK than that of anyone else's. Reference to the Cadbury Report and

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its Code is now to be found in many companies' annual reports, although there was no obligation for them to do anything until after 30 June 1993. The question of compliance is considered below.

When considering what Cadbury recommended, it is convenient to look at it in three distinct areas – though they are related – namely structure, process, and standards.

It is common knowledge that in any organization the dynamics of the relationships between the people in it are of cardinal importance. The point about having a sound structure is to improve the quality of the dynamics but no structure can actually assure it. The structure of the boards of two companies may look identical on paper, but they may perform totally differently because of the personalities. Even so, it is not unreasonable to suggest that certain types of structure improve the possibility that the dynamics will operate satisfactorily, though more than this cannot be claimed. There are no panaceas: checks and balances are needed but not so as to balance a business out of existence.

The important points on structure in the Cadbury Code are, first the requirement that companies should have non-executive directors (1.3), which is in fact inherent in another recommendation – that boards should have audit committees (4.3), composed of outside directors. The Code goes on to suggest that the non-executive directors should have specific terms of reference (2.3), and should be independent (2.2). As a further point of structure, it recommends the creation of a remuneration committee (3.3).

The committee debated at length the question of the top structure of the company, and in particular whether the chief executive (whatever the title), should also be chairperson of the board. There was a general feeling that the concentration of power which resulted when a person had to perform both roles was generally undesirable – quite apart from its being extremely onerous – and that a preferable system was one in which the roles were separated, even in small public limited companies. It recognized, however, that to be categorical had its drawbacks. At times a concentration of power might be thought desirable: sometimes an unexpected death or defection poses severe problems; and there is always the possibility that a categorical requirement will produce a superficial response, that is, a formal division of power which obscures its real concentration. The solution Cadbury proposed (1.2) was that one of the non-executive directors should be a recognized senior member. The idea was not that he should act as a "leader of the opposition" on the board, but simply that it might be useful in certain circumstances for the other members of the board to have a focal point for discussion if the circumstances warranted it.

A most important element in the process concerns the appointment and selection of directors in the first place. It is the subject of a separate recommendation (2.4). The committee felt it vitally important that the selection process should be thorough and systematic and not left to whims, chance, and vagaries of a CEO's personal predilections and acquaintanceships.

The committee also looked at how the board did its work, suggesting that its meetings should be regular (1.1). This sounds so obvious as to be scarcely worth stating – had not many members of the committee known of companies where it was not the case. We also suggested that the board should have a formal schedule of the matters that were reserved to it (1.4). Part of the process would be that the directors should explain their responsibilities (4.4), report on the effectiveness on internal controls (4.5), and disclose their remuneration (3.2). The underlying principles are that responsibilities in the fields of financial reporting and control should be irrevocably clear and that there must be adequate disclosure because it is central to accountability. It also suggested that the directors should have a clear drill for getting professional advice about the performance of their jobs when they felt they needed it (1.5). Experience has shown that these circumstances are likely to be quite rare but may be very important, and it is unfair to force directors to foot the bill themselves or, in the last resort, sue the company for reimbursement.

A number of the recommendations touch on standards. For instance, 1.1 suggests that the board as a whole should have full and effective control over management. I think it is quite a good test to check pragmatically that that is the case. Arguably, if the board does not perform this role it is not a board at all but simply an enlarged management committee. I used to argue for the "acid test " rule, that is whether in the last resort the board can say *no* to the CEO. The point is that only if there is reciprocal respect are the dynamics likely to be satisfactory. Again – and dealing with relationships – the Code (4.2) covers the relationship with the firm's auditors which it says must be objective. But it stresses also directors' own responsibilities for presentation of information (4.1), and requires it to be a balanced and understandable assessment. The report and accounts, in other words, should convey to anyone who reads them a clear and accurate impression of how the company performed, what its present position is, and what its future prospects are. It needs to knit together the words and figures that cover this ground and tell a comprehensible and readable story. Part of this, which the committee have picked out in particular because it is so important, is the responsibility of the directors to ensure that the company is in fact a going concern (4.6). They are entitled to assume this under the Companies Acts, but the committee felt that many a company might have been saved if the directors had faced up to this question earlier, as it might have enabled them to take the necessary remedial action in time.

Internal controls

The main passage on internal controls in the Report is at paragraph 5.16 which envisages two-part action. It is the directors' job to satisfy themselves that internal controls are satisfactory and the auditors' to report on the directors' statement. The directors' duty is repeated at paragraph 4.5 of the Code. Then, however, come the weasel words of Note 13 which says in effect "It's all too difficult. Directors cannot be expected to report until they have received guidance". The ball is then passed to the accounting profession; in rugby I think this is called a hospital pass.

What this means in practice is that audit committees, which are now blooming like flowers in the desert after spring rains, cannot really complete the job set them in paragraph 4.39 of the Report. There is, however, no excuse for inactivity. Of course all audit committees ought already to be concerned with systems of internal control; and they ought to be in discussion with the internal auditors (when there are any). This much is spelt out in 4.35(f). But they

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are not expected to report until the guidelines are prepared.

I expect you all know what the current position is about these guidelines. A lengthy set were prepared at the Institute's request by a group of producers and users of accounts, and, this is out for discussion before the APB consider them. There is some hesitancy about them, born of a fear that length and complexity will not assist the task. There are those who would prefer a short statement of key principles on the lines of those suggested by the Scottish Institute. At the moment there is no agreement or guidance but it is very much to be hoped that the profession will be able to move forward without undue delay.

Meanwhile, life goes on. I expect that up and down the country boards and audit committees will be doing the sensible thing, putting internal controls on the agenda, thinking how, without undue cost, they can beef them up and strengthen the internal audit function. But the plain fact is that 4.5 of the Code is not yet in force so directors are not yet obliged to report and in that particular regard the auditors have no comment to make.

The effects of Cadbury

Enforcement

The committee realized that some companies would find it much more difficult to implement the Code than others, that it might take them some time, for instance, to find suitable people for the board. The solution, therefore, was to ask companies which reported after 30 June 1993 to state (1.3) whether they complied and to give reasons for not doing so. The Stock Exchange is checking to see whether a compliance statement has been made and will take appropriate action if it is not. If this statement is made it will be up to shareholders to decide what to do about any elements they consider unsatisfactory and they will need to take into account the gravity and urgency of the matter, viewed against the background of a company's performance. At the very least the Cadbury Code provides shareholders with an agenda for discussions with a company's board on corporate governance issues.

What is happening in fact is that various interested parties are beginning to monitor company reports to see what the board purports to have done, e.g. the appointment of non-executive directors, and are trying to assess their degree of independence – or lack of it (not easy to assess). PIRC, for instance, has started analyses of this sort for the benefit of their subscribers, and various shareholder bodies are considering how best to keep an eye on compliance with the code – no mean feat as there are about 2,000 of them. I think it highly likely that unless there are special circumstances, attention will focus in the first place on major companies, simply because they represent such a considerable slice of most funds' portfolios, and on lesser companies that are in trouble. They may resent the Code, but I do not think it will be wise for them to disregard or underestimate it. They will have to bear in mind that pressure for compliance is likely to grow rather than diminish. When they look at the subject more broadly, as the committee did, they too may feel that this report probably marks the ultimate step in voluntarism, i.e. if companies do not respond adequately, pressure will grow under this administration, or the next, for statutory reform. Indeed, there was criticism from some quarters that the committee had not gone far enough and that statutory reform was already overdue.

In fact, those monitoring company reports have as yet little material on which to work since this is the quiet time of the year. From now on, however, the pace will quicken as more companies have year ends of 30 September or 31 December. Such reports as I have seen do indicate that statements of compliance are always included but that compliance in regard to the recommendations is widespread but not universal.

PIRC, looking at companies earlier in the year, noted that some had seemed to anticipate the 30 June date by appointments to the board and in some cases splitting the CEO/chairperson's roles and/or making a statement on corporate governance.

More recently there have been attitude surveys; the most recent I have encountered was produced by Coopers & Lybrand this month. This is based on a sample of 84 companies so I would not read too much into it. Even so, it showed widespread support for Cadbury, but rather over half do not intend to comply in full. (Sharp division between big and small companies – 83 per cent-17 per cent full compliance respectively.)

The largest single difficulty was the number of non-executive directors for smaller companies (three were thought to be too many), particularly as many had small boards. The biggest effect is the use of audit committees in smaller companies. On internal controls, only 23 per cent had an internal audit function and only 7 per cent of those with turnover less than £50m. Where there were audit committees 64 per cent saw the overall review of the effectiveness of internal *controls* as being their task but only 36 per cent for the effectiveness of internal audit; contrast this with 98 per cent for the review of external audit findings and 96 per cent for the review of annual financial statements.

There is some opposition to Cadbury Code 4.5 – about 23 per cent disagreed with it. Understandably, given that guidance is yet to be issued, there was widespread uncertainty about the reporting function.

Even so – and even in the absence of guidelines – it appears that 46 per cent of companies intend making a statement next time round on the effectiveness of internal controls and will variously: discuss them with the internal auditors (75 per cent); arrange an internal review of controls (36 per cent); commission an independent assessment (7 per cent); and rest on existing internal and external audit (49 per cent).

Further issues

Boards

The Cadbury Committee realized that its terms of reference did not cover the whole field of corporate governance, and that the issues on which it gave some guidance were difficult and complex. It therefore set itself a task of seeing for the next year or two, how the Code was working in practice and of trying to establish the main points which a successor body might consider in 1995.

It would be premature to conjecture what the future agenda would be in any detail, but there are already indications of some of the subjects which command particular interest, for instance:

- Whether the increased responsibilities based on non-executive directors impose too heavy a burden on them; whether this affects recruitment; and what implications this has for their remuneration.

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- Although the Cadbury Report stresses the contributory as well as the monitoring role of the non-executive director, there are fears that emphasis on the latter may be unduly divisive. Is this so in practice? Are the fears groundless? What is the relationship of this issue and the consideration of alternative structures like having a supervisory board?

Shareholders

It was not within the Cadbury terms of reference to look at most of the issues concerning shareholders. Even if all the Cadbury recommendations are put into place, however, it may still happen that a company's board does not work very well and that it is incapable of improving itself. This is clearly a legitimate area of interest for shareholders whose main power under the Companies Act (other than approving the accounts) is to elect the directors. As the Institutional Shareholders Committee recognizes, this is their main and proper sphere of influence in corporate governance matters. The question for further consideration, therefore, is how this interest can best be exercised in a practical way. What implications does it have for the attitude of shareholders towards the companies in which they invest? Is it good enough to treat shares as if they were mere commodities? Do they look at the composition of the board carefully and record their votes knowingly? What kind of communication should they have with companies, and what problems are there, legally and logistically, in getting closer to the companies in which they invest? What practical steps can shareholders take to reduce the "free-rider" problem, i.e. why should one shareholder with, say, 0.5 per cent of the shares go to the expense and trouble of taking action, the benefits of which are shared by the other 99.5 per cent who have not raised a finger?

Internal controls

I do not see the subjects of internal controls and internal audit as *issues*. I think there is a consensus that they are important and warrant proper attention from senior management and board. There will be concern about standards, guidance and costs. Perhaps directors will have a sharpened sense of their responsibilities and liabilities; this may depend on how they fare in lawsuits and, given the English system, there seems little extra danger of these – as yet. Perhaps we should take note of a special case in Australia where the auditors were sued but the directors were made co-defendants, and the judge, on the facts, found that they were both liable and apportioned the damages.

Trustees

Another area for consideration is the role of trustees. A very large proportion of UK equities are now in pension funds, and formally owned by the trustees of those funds who generally bring in professional managers. What does this imply about the trustees' role and the knowledge they bring to bear to it? Does it mean, for instance, that they should have some basic financial training? The Tumin Report, dealing with the trustees of charitable institutions, made recommendations on these lines: *a fortiori* they should apply to the trustees of pension funds.

Accountability

The big underlying issue of principle is that of accountability. The foundation of the modern company structure with its whole legal basis depends on the notion that those who are responsible for deploying a very large proportion of a nation's resources have a clear line accountability and this runs to the shareholders. Accountability implies not only information, but also the willingness of those to whom they are accountable to listen, to understand, and, where necessary, to act as a result of what they perceive. If shareholders do not, or indeed find that they cannot fulfil this role, then it casts a shadow on the legitimacy of the modern corporation.

Appendix
Report of the Committee on the Financial Aspects of Corporate Governance: The Code of Best Practice

Introduction

1 The Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession to address the financial aspects of corporate governance.

2 The Committee issued a draft report for public comment on 27 May 1992. Its final report, taking account of submissions made during the consultation period and incorporating a Code of Best Practice, was published on 1 December 1992. This extract from the report sets out the text of the Code. It also sets out, as "Notes", a number of further recommendations on good practice drawn from the body of the report.

3 The Committee's central recommendation is that the boards of all listed companies registered in the United Kingdom should comply with the Code. The Committee encourages as many other companies as possible to aim at meeting its requirements.

4 The Committee also recommends:

(a) that listed companies reporting in respect of years ending after 30 June 1993 should make a statement in their report and accounts about their compliance with the Code and identify and give reasons for any areas of non-compliance;

(b) that companies' statements of compliance should be reviewed by the auditors before publication. The review by the auditors should cover only those parts of the compliance statement which relate to provisions of the Code where compliance can be objectively verified (see note 14).

5 The publication of a statement of compliance, reviewed by the auditors, is to be made a continuing obligation of listing by the London Stock Exchange.

6 The Committee recommends that its sponsors, convened by the Financial Reporting Council, should appoint a new Committee by the end of June 1995 to examine how far compliance with the Code has progressed, how far its other recommendations have been implemented, and whether the Code needs updating. In the meantime the present Committee will remain responsible for reviewing the implementation of its proposals.

7 The Committee has made clear that the Code is to be followed by individuals and boards in the light of their own particular circumstances. They are responsible for ensuring that their actions meet the spirit of the Code and in interpreting it they should give precedence to substance over form.

8 The Committee recognises that smaller listed companies may initially have difficulty in complying with some aspects of the Code. The boards of smaller listed companies who cannot, for the time being, comply with parts of the Code should note that they may instead give their reasons for non-compliance. The Committee believes, however, that full compliance will bring benefits to the boards of such companies and that it should be their objective to ensure that the benefits are achieved. In particular, the appointment of appropriate non-executive directors should make a positive contribution to the development of their businesses.

The Code of Best Practice

1 *The Board of Directors*

1.1 The board should meet regularly, retain full and effective control over

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the company and monitor the executive management.

1.2 There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member.

1.3 The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions (note 1).

1.4 The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands (note 2).

1.5 There should be an agreed procedure for directors in the furtherance of their duties to take independent professional advice if necessary, at the company's expense (note 3).

1.6 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of the company secretary should be a matter for the board as a whole.

2 *Non-executive directors*

2.1 Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.

2.2 The majority should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement, apart from their fees and shareholding. Their fees should reflect the time which they commit to the company (notes 4 and 5).

2.3 Non-executive directors should be appointed for specified terms and reappointment should not be automatic (note 6).

2.4 Non-executive directors should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole (note 7)

3 *Executive Directors*

3.1 Directors' service contracts should not exceed three years without shareholders' approval (note 8).

3.2 There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid UK director, including pension contributions and stock options. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained.

3.3 Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors (note 9).

4 *Reporting and Controls*

4.1 It is the board's duty to present a balanced and understandable assessment of the company's position (note 10).

4.2 The board should ensure that an objective and professional relationship is maintained with the auditors.

4.3 The board should establish an audit committee of at least 3 non-executive directors with written terms of reference which deal clearly with its authority and duties (note 11).

4.4 The directors should explain their responsibility for preparing the accounts next to a statement by the auditors about their reporting responsibilities (note 12).

4.5 The directors should report on the effectiveness of the company's system of internal control (note 13).

4.6 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary (note 13).

Notes. These notes include further recommendations on good practice. They do not form part of the Code.

1 To meet the Committee's recommendations on the composition of sub-committees of the board, boards will require a minimum of three non-executive directors, one of whom may be the chairman of the company provided he or she is not also its executive head. Additionally, two of the three non-executive directors should be independent in the terms set out in paragraph 2.2 of the Code.

2 A schedule of matters specifically reserved for decision by the full board should be given to directors on appointment and should be kept up to date. The Committee envisages that the schedule would at least include:

(a) acquisition and disposal of assets of the company or its subsidiaries that are material to the company;

(b) investments, capital projects, authority levels, treasury policies and risk management policies.

The board should lay down rules to determine materiality for any transaction, and should establish clearly which transactions require multiple board signatures. The board should also agree the procedures to be followed when, exceptionally, decisions are required between board meetings.

3 The agreed procedure should be laid down formally, for example in a Board Resolution, in the Articles, or in the Letter of Appointment.

4 It is for the board to decide in particular cases whether this definition of independence is met. Information about the relevant interests of directors should be disclosed in the Directors' Report.

5 The Committee regards it as good practice for non-executive directors not to participate in share option schemes and for their service as non-executive directors not to be pensionable by the company, in order to safeguard their independent position.

6 The Letter of Appointment for non-executive directors should set out their duties, terms of office, remuneration, and its review.

7 The Committee regards it as good practice for a nomination committee to carry out the selection process and to make proposals to the board. A nomination committee should have a majority of non-executive directors on it and be chaired either by the chairman or a non-executive director.

8 The Committee does not intend that this provision should apply to existing contracts before they become due for renewal.

9 Membership of the remuneration committee should be set out in the Directors' Report and its chairman should be available to answer questions on remuneration principles and practice at the Annual General Meeting. Best practice is set out in PRO NED's Remuneration Committee guidelines, published in 1992. (Available at the price of £5 from PRO NED, 1 Kingsway, London WC2B 6XF. Tel: 0171 240 8305.)

10 The report and accounts should contain a coherent narrative, supported by the figures, of the company's performance and prospects. Balance requires that setbacks should be dealt with as well as successes. The need for the report to be readily understood emphasises that words are as important as figures.

11 The Committee's recommendations on audit committees are as follows:

(a) They should be formally constituted as sub-committees of the main board to whom they are answerable and to whom they should report regularly; they should be given written terms of reference which deal adequately with their membership, authority and duties; and they should normally meet at least twice a year.

(b) There should be a minimum of three members. Membership should be confined to the non-executive directors of the

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company and a majority of the non-executives serving on the committee should be independent of the company, as defined in paragraph 2.2 of the Code.

(c) The external auditor and, where an internal audit function exists, the head of internal audit should normally attend committee meetings, as should the finance director. Other board members should also have the right to attend.

(d) The audit committee should have a discussion with the auditors at least once a year, without executive board members present, to ensure that there are no unresolved issues of concern.

(e) The audit committee should have explicit authority to investigate any matters within its terms of reference, the resources which it needs to do so, and full access to information. The committee should be able to obtain outside professional advice and if necessary to invite outsiders with relevant experience to attend meetings.

(f) Membership of the committee should be disclosed in the annual report and the chairman of the committee should be available to answer questions about its work at the Annual General Meeting.

Specimen terms of reference for an audit committee, including a list of the most commonly performed duties, are set out in the Committee's full report.

12 The statement of directors' responsibilities should cover the following points:

- the legal requirement for directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company (or group) as at the end of the financial year and of the profit and loss for that period.
- the responsibility of the directors for maintaining adequate accounting records, for safeguarding the assets of the company (or group), and for preventing and detecting fraud and other irregularities;
- confirmation that suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the financial statements;
- confirmation that applicable accounting standards have been followed, subject to any material departures disclosed and explained in the notes to the accounts. (This does not obviate the need for a formal statement in the notes to the accounts disclosing whether the accounts have been prepared in accordance with applicable accounting standards.)

The statement should be placed immediately before the auditors' report which in future will include a separate statement (currently being developed by the Auditing Practices Board) on the responsibility of the auditors for expressing an opinion on the accounts.

13 The Committee notes that companies will not be able to comply with paragraphs 4.5 and 4.6 of the Code until the necessary guidance for companies has been developed as recommended in the Committee's report.

14 The company's statement of compliance should be reviewed by the auditors in so far as it relates to paragraphs 1.4, 1.5 2.3, 2.4, 3.1 to 3.3, and 4.3 to 4.6 of the Code.

NEWS

New video features prominent CEO and audit committee members

In a new video from the Institute of Internal Auditors, John Reed, CEO of CitiCorp, makes a rare appearance to share his views on corporate governance and the importance of effective internal controls as a defence against fraud and business failure.

In an excerpt from the video, entitled *Audit Committees and Internal Auditing: An Essential Alliance for Effective Governance*, Reed says, "We are expected to certify to the outside world that we have operative control systems...Being well managed, being in control...implies that you have audit, an immune system, a feedback system". He also gives his views on the role of audit committees and how they should operate.

The 35-minute video also features two prominent audit committee members – Mary Metz, audit committee member for Pacific Gas & Electric and other organizations, and Patricia Carbine, audit committee chairperson for New York Life Insurance Company. Metz and Carbine talk candidly about effective internal controls, their role in corporate governance, how internal auditors can work together with the audit committee, and the importance of audit committee education and self-assessment.

The video was introduced in July 1994 and more than 100 copies were sold in the first two weeks. According to Elaine McIntosh, manager of Educational Products for the IIA, "We're very pleased with the success of *Audit Committees and Internal Auditing*, but not too surprised. Audit executives have been requesting a tool like this for a long time. Many are showing it to their audit committees, which is a great way of opening the door to useful dialogue. It's also an effective orientation tool for new audit committee members".

A companion reference booklet, *The Audit Committee: A Briefing on Roles and Responsibilities*, outlines good practice guidelines, offers tough questions for the committee to ask the auditors, and provides samples of a committee charter and chairperson's letter.

The video and companion booklet can be ordered by contacting the Institute of Internal Auditors Customer Service Center on 407 830 7600 (Ext. 1), Fax: 407 831 5171. *Audit Committees and Internal Auditing: An Essential Alliance for Effective Governance*, Order No. 6928, which includes one video and companion booklet, is $350 for IIA members and $450 for non-members. *The Audit Committee: A Briefing on Roles and Responsibilities*, Order No. 7946, is $15. They are also available through IIA – UK.

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