EXPLORING THE PRINCIPLES FOR INCREASING INTEGRITY, OBJECTIVITY IN EXTERNAL AUDITS

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Because the integrity and objectivity of information are vital to the quality of audit outcomes, records and information management professionals have an important role to play in the audit process.

This article proposes that incorporating the records and information management (RIM) function and Generally Accepted Recordkeeping Principles® (the Principles) into the financial statement audit process will enhance audit integrity and objectivity, increasing the quality of audit outcomes. Therefore, as RIM professionals define and refine the business case for RIM, their potential role in the external audit process should be included.

Internal vs. External Audits

In their November/December 2011 *Information Management* article, "Dodd-Frank Act Puts Focus on Information Governance," Fred Pulzello and Sonali Bhavsar described the Principles as "an important consideration in today's volatile financial market because they help organizations evaluate their current risk state specific to records, disclosures, compliance, and supervision rules, as well as provide a roadmap to mitigate the risk." They also note that the Principles can be used to satisfy the requirements of the Dodd-Frank Act (Pub. L. 111-203), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission, and the Federal Reserve, as well as other organizations.

Joanne Frampton, in her March/April 2012 *Information Management* article, "GARP®: A Tool to Drive Internal Auditing," reported, "When RIM is incorporated into the corporate governance and risk management framework and integrated into the internal audit regime, the [Principles] methodology can underpin and drive the entire audit process." She commented that the Principles have "provided the necessary framework and vocabulary to communicate to executives the importance of RIM."

Although Frampton addressed RIM and the Principles in the *internal* audit regime, to date the role that RIM and the Principles can fulfill in the *external* audit process has not been posited.

The External Audit Framework

External audits of financial statements prepared in the United States are performed according to Generally Accepted Auditing Standards (GAAS).

For companies not registered with the SEC, GAAS are established by the Audit Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA). For companies registered with the SEC, GAAS are established by the Public Company Accounting Oversight Board.

The ASB began working on a redrafting and recodification of its U.S. GAAS in 2004, in what is called the Clarity Project. According to the "Clarity Project: Questions and Answers" on the AICPA website, only AU section 322, "The Auditor's Consideration of the Internal Audit Function," remains to be addressed, and it is expected to be released in late 2013 or early 2014.

Audit Principles

One result of the ASB's Clarity Project is Statement on Auditing Standards (SAS) No. 122, "Clarification and Recodification," which is effective for audits of financial statements for periods ending on or after December 15, 2012.

The preface of SAS 122 identifies principles that underlie an audit conducted in accordance with GAAS. These principles fall into four categories:

1. Purpose of an audit and premise upon which an audit is conducted
2. Responsibilities
3. Performance
4. Reporting

The order of the principles highlights the sequence in which an audit is conducted. Each stage of an audit builds upon the work of the prior stages. If specification of the purpose and premise of the audit lacks quality, the remainder of the audit, at a minimum, will lack the same quality.

The first auditing principle, purpose of an audit and premise upon which an audit is conducted, specifically addresses the responsibilities of organizational management and governance. In a financial statement audit, as specified in SAS 122, AU-C 200, paragraph A2, management is responsible:

a. For the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
b. For the design implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error; and
c. To provide the auditor with
    i. Access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
    ii. Additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and
    iii. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

To the extent that RIM, based on the Principles, improves satisfaction of management's financial statement audit responsibilities, the integrity of the foundation upon which the audit is conducted will improve.

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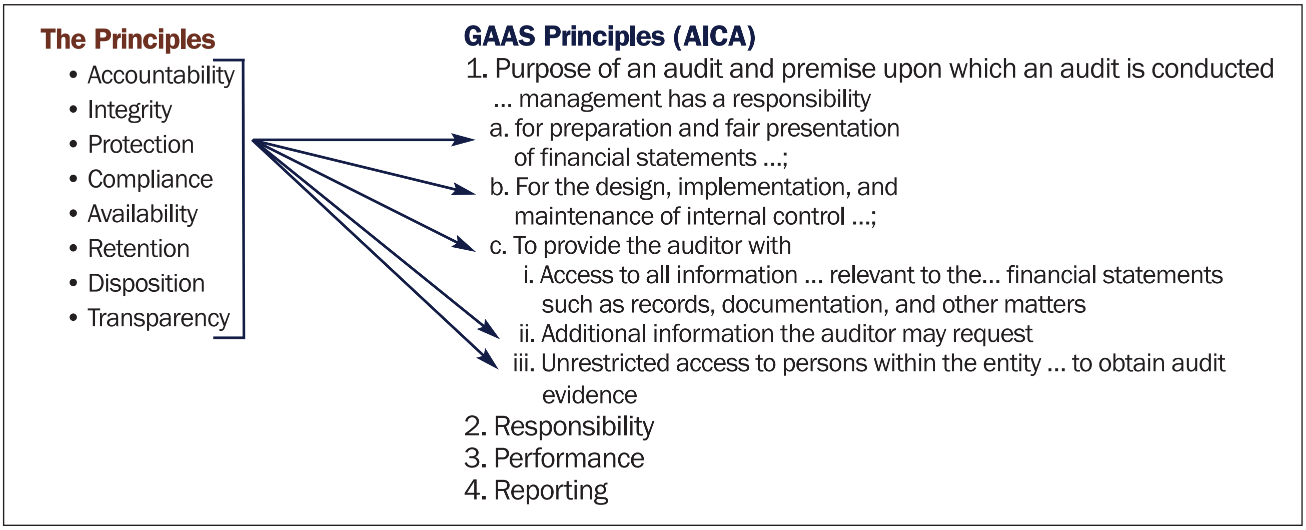

Figure 1: The GAAS Elements Directly Affected by the Principles

Business entities generate a voluminous amount of information. This information must be adequately maintained because it is utilized for key internal and external decisions. According to ARMA International's Principles' website (*www.arma.org/principles*), the Principles were established to assist organizations as they build and improve their RIM systems.

Each of the eight Principles can positively affect elements of organizational management's audit responsibilities.

Principle of Accountability

The Principle of Accountability ensures that the organization has identified an individual with the responsibility and – more importantly, the authority – to design and implement a documented, auditable RIM program. Further, this principle mandates the establishment of a governance structure which will, ideally, incorporate RIM into the organizational culture.

Financial statement auditors note that information products produced by the audited organization are the sole responsibility of the organization.

For example, according to the AICPA's AU 508, "Reports on Audited Financial Statements," the auditor's standard unqualified report for a public company includes the statement "These financial statements are the responsibility of the company's management."

According to SAS No. 122, similar language is used in the auditor's standard unmodified report for a non-public company.

Principle of Integrity

The Principle of Integrity demands that organizational records and information can be reasonably guaranteed to be authentic and unaltered.

Information that exhibits integrity is absolutely foundational and vital to the integrity of the audit process and audit results. The auditor, according to AU 110, "Responsibilities and Functions of the Independent Auditor," is responsible for providing reasonable assurance that there are no material misstatements, whether due to error or fraud.

However, financial statement auditors are rarely responsible for document authentication, according to AU 316, "Consideration of Fraud in a Financial Statement Audit."

The Principle of Integrity is critical to the audit process, and it is the responsibility of management to ensure the integrity of organizational records and information. To the degree an organization has implemented a RIM function based on the Principles, overall confidence in the integrity of records and information should increase.

Principle of Protection

The Principle of Protection dictates that records and information are afforded a reasonable level of protection to ensure the preservation of privacy and confidentiality. This principle is extremely broad, but from the perspective of an audit, it relates to internal controls that protect the integrity of an entity's documented information.

Essentially, the Principle of Protection, correctly implemented, attempts to ensure that only those authorized to create, modify, and/or delete organizational information can do so and that such activity is adequately documented to ensure accountability.

It is management's responsibility to implement internal controls that ensure adequate record and information protection. A Principles-based RIM program will help management incorporate adequate protection to ensure records and information exhibit integrity and that organizational processes and procedures preserve privacy and confidentiality.

Principle of Compliance

The Principle of Compliance requires that a RIM program manages organizational records and information in a manner that satisfies legislative and industry requirements. It is ultimately management's responsibility, but RIM is a vital component in achieving compliance.

The Principle of Compliance is possibly the best example of the interrelatedness of various principles. In order for an organization to be compliant, the Principles of Accountability, Integrity, and Protection must be adequately operationalized.

At a minimum, according to AU 314, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," GAAS require the auditor to obtain an understanding of the design of a company's internal control system and whether the system is implemented.

In certain instances, the financial statement auditor will test the effectiveness of components of the internal control system, according to AU 314 and AS 5, "An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements." Adequate satisfaction of the Principle of Compliance is necessary to meet even minimum expectations in an external audit.

Principle of Availability

The Principle of Availability requires that records are maintained "in a manner that ensures timely, efficient, and accurate retrieval of needed information." The comprehensive scope of the Principles, almost by definition, includes objectives and characteristics that are in conflict.

For example, in order for records to be useful, they must be available, yet the ultimate implementation of the Principles of Integrity and Protection would so limit access that information would be of limited analytical value. The key is to strike an organizationally appropriate balance among the Principles.

A well-designed and implemented RIM program based on the Principles ensures that auditors not only have access to information, but that through the RIM function they potentially have a single resource for the identification, extraction, aggregation, and delivery of the information.

The RIM function is, in all likelihood, the only resource in an organization where knowledge of the organization, definition, format, and location of most, if not all, organizational records and information exists.

Were the RIM function tasked as the primary auditor resource for information in the audit process, fewer financial resources would be expended to retrieve the necessary information and to identify the people with adequate access rights to that information.

Further, since the RIM function does not have custodial responsibility for information, i.e., its creation and modification, the information extracted for the audit exhibits higher credibility.

Principle of Retention

The Principle of Retention requires that records and information are retained through their useful and/or legal life. Adequate implementation of the Principle of Retention ensures that records are available to auditors for the timespan encompassed by the audit. The Principle of Retention cannot be adequately discussed without simultaneous consideration of the Principle of Disposition since retention is bounded by disposition.

Principle of Disposition

The Principle of Disposition requires that once retention requirements have been satisfied, records and information will be securely and appropriately deleted. Secure and appropriate disposition preserves the privacy and confidentiality afforded retained records by the Principle of Protection.

While the Principles of Disposition and Retention would seem to embody opposite objectives, they form an integrated, mutually supportive whole. The Principles of Retention and Disposition collectively define the timespan over which organizational records and information are available.

Only through the RIM function can retention and disposition be organizationally implemented and controlled – a Principles-based RIM program will help to ensure that management has met its retention and disposition responsibilities.

Further, by systematically disposing of records once retention requirements have been satisfied, the organization will minimize the resources required to maintain, retrieve, and analyze information.

Regarding the audit function, an intelligent and comprehensive retention and disposition process greatly improves the efficiency of an audit.

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	GAAS Purpose and Premise Elements				
The Principles	**a**	**b**	**c.i**	**c.ii**	**c.iii**
Accountability	X	X		X	X
Integrity	X	X	X		
Protection	X	X	X	X	
Compliance	X	X	X	X	
Availability	X	X	X	X	X
Retention	X	X	X	X	
Disposition	X	X	X	X	
Transparency	X	X	X	X	X

Table 1: The Principles/GAAS Purpose and Premise Cross Reference

Principle of Transparency

The Principle of Transparency dictates that an organization's RIM policies and procedures must be understandably documented and that said documentation will be available to appropriate parties.

Transparency in the RIM program is vital to ensuring a successful audit because RIM policy and practices are part of an organization's internal controls – controls which must be understood as part of the audit, according to AU 314.

Further, transparency of RIM policy and procedures will increase auditor confidence in the integrity of the information upon which the audit is conducted. This increased confidence may:

1. Increase the speed with which the audit is conducted
2. Decrease the amount of investigation the auditor feels is necessary to ensure integrity
3. As a result of benefits 1 and 2, potentially decrease the overall cost of the audit

The Principles and Audit Independence

Table 1 cross references the Principles and GAAS elements and highlights the extensive effect the incorporation of RIM, built upon a foundation of the Principles, will have on the financial statement audit process.

Just as proper utilization of the Principles can support and strengthen the internal audit process, a Principles-compliant RIM program can increase the level of integrity and objectivity in an external audit.

The AICPA Code of Professional Conduct ET 101, "Independence," requires auditors be independent of their audit clients, and ET 102, "Integrity and Objectivity," requires them to conduct their audit with integrity and objectivity.

All too often, however, the auditor must request information from individuals who are directly responsible for the information's creation and maintenance. The level of integrity and objectivity in the audit process could be increased if the auditor was able to request information directly from the RIM function independent of the individuals with custodial responsibility.

Further, auditors spend time simply locating information and those who have access to information. The RIM function is potentially a single organizational source of information, of knowledge regarding who has access to information, and of organizational policies associated with information usage and internal controls. The resources required to gather audit information could be greatly reduced if the RIM function served as the primary contact for external auditors.

Conclusion

Financial statement audits are a statutory requirement for publicly traded organizations. Financial statement audits are often required by financial institutions or other stakeholders for privately held organizations. This article cross-references Generally Accepted Recordkeeping Principles® and Generally Accepted Auditing Standards to show how the Principles positively affect the financial statement audit process and outcomes.

Organizational management has several responsibilities in the audit process, the satisfaction of which is the bedrock upon which audit quality is founded. Each of the Principles directly and positively affects management's satisfaction of its audit responsibilities. Consequently, a RIM program built on a foundation of the Principles has business benefits that include, but are not limited to, improvements in the efficiency and, quite possibly, the effectiveness of the external audit function. Records managers should include external audit process benefits in the business case for incorporating the Principles into their organization's RIM program. **END**

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