

PUBLISHER'S FOREWORD

The keystone of all systems of protection must be auditing. – *Harvey Cardwell*

This book, a revised and condensed version of an original work by Harvey Cardwell, is about protection. Specifically, *Principles of Audit Surveillance* is about the protection that may be afforded by the service of accountants to owners, and in turn society generally, against many of the forms of “inside theft.”

Inside theft, an *accounting term* grounded in the proprietorship equation, is defined as “the fraudulent transfer of value from owners, undertaken by employees for their own benefit or that of their accomplices.” Inside theft consists fundamentally of the *theft act*, but is usually combined with *concealment manipulations* and *conversional manipulations*. The impact of each of these distinct phases on the books and records of the firm – the jurisdictional purview of the accountant – are the source of auditable evidence. While theft acts, concealment, and conversions can be combined in “infinite variety,” the principles of audit surveillance remain timeless and immutable.

Cardwell's rigorous application of the scientific method to the study of the “abnormal phenomena that are introduced into accounts” yields a focused analysis of the “immoral appropriation of an employer's assets,” which at the same time evolves into a major treatise comprising a “comprehensive conception of the field of fraud” and of the “art of protecting society from the inside thief.”

To provide this protection, Cardwell outlines a comprehensive six part system for the detection and deterrence of inside theft. Audit surveillance, but one component of this system, is a strategy centered on the books and records which uses incisive tests of limited scope to detect the evidence of such thefts. It is, in short, a risk-based application of the common sense notion that to detect something, one must test for it.

Without understating the difficulty of the task, and insisting upon a practical cost-benefit approach, Cardwell delivers the optimistic conception that auditable evidence can lead to discovery of inside thefts; that this discovery, and/or the potential thereof, can and will lead to the effective deterrence of such thefts; and that this deterrence is a vitally important form of ownership protection.

That such ownership protection is a proper function of the accountant is not presented as mere historical fact or dogma. Instead, by demonstrating that inside theft is not inscrutable, but rather subject to objective analysis and understanding – at least at the level of the abnormal accounting phenomena which it entails – Cardwell challenges the profession to embrace this responsibility.

Whether one accepts Cardwell's complete vision of ownership protection or not, *Principles of Audit Surveillance* delivers an insightful – and necessary – framework through which inside theft may be described, understood, measured, and communicated. That is, it provides both the fundamental accounting principles related to inside theft as well as the basic logic and language of auditing for fraud. This alone must certainly place Cardwell among the leading auditing theorists of the past century, and makes *Principles of Audit Surveillance* forever relevant to the profession.

Indeed, the relevance of Cardwell has not been lost on the profession. In recent years, Douglas R. Carmichael, Chief Auditor and Director of Professional Standards of the Public Company Accounting Oversight Board (PCAOB) in the United States, has made numerous professional presentations which have highlighted the significance of certain aspects of Cardwell's work. Perhaps Dr. Carmichael recognizes, as Cardwell himself had hoped, that *Principles of Audit Surveillance* offers “a sound beginning toward understanding and controlling the inside theft.”

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In his Preface to the original edition, Cardwell describes the pedagogy of *Principles of Audit Surveillance* as following the “additive textbook method,” whereby concepts and corresponding new terminology are introduced, defined, and discussed in planned order. It may be more helpful, however, to consider *Principles of Audit Surveillance* as following what is now generally described as the “spiral textbook method,” whereby ideas and terminology are introduced and defined to the extent necessary to move the presentation forward, but are often revisited and reintroduced later. Important concepts and terminology are frequently broadened, refined, or nuanced with additional context as the book progresses. Thus, the reader is advised that a full and complete understanding of Cardwell's principles of accounting for inside theft, his framework for audit surveillance, and his general system for protection against inside theft can best be obtained only upon a complete sequential reading of the treatise.