

## Internal Audit: "A Necessary Evil" or A Creator of Added Value?

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### Abstract

*The present work focuses on the problem of creating added value by the department (service) of internal audit. This basically is a creator of new value by saving resources and avoiding losses due to disturbing factors that may appear at a certain moment in the entity's activity.*

*The concept of "added value" in the internal audit activity is a controversial concept and the auditor is an "independent valuator" of the efficient use of resources inside the entity. The specialty literature and the practice allow the possibility to identify premises and factors on which the performance of the internal audit function depends on. A method to measure the performances of the internal audit department inside the entities is the "Synoptic scoreboard". This instrument allows identifying the fields the internal audit can bring an added value to the entity and the impact of the internal audit function on the performances, including the financial ones.*

**Key words:** internal audit, added value, "Synoptic score tables", performance

**J.E.L. classification:** M42

### 1. Introduction

The objective of each entity is obtaining added value by focusing the economic agents' activity on improving their performances. This is not possible without satisfying the demands, under a permanent competition to enlarge their clients by a proposal for more performing, superior, better goods and services at accessible prices.

In a market economy, the competition represents the engine of economic development and the internal audit has a special role in ensuring the stability of the economic entity.

The standards for *Internal Auditing professional practice* issued by the Internal Auditing Institute from USA (IIA), especially, Standard 2000, named "The "Conducting internal auditing work" stipulated the following: "The executive management of the audit must conduct the internal auditing activity in an efficient way to ensure the creation of added value inside the organization".

The internal audit is a promoter of added value by a resources economy that creates and avoiding loses due to some disruptive activity factors. The purpose of an efficient internal audit department is to ensure that reducing the activity is as limited as possible and that the safety net is tight enough. Thus, a possible reduction of the volume of activity and the financial result is not dangerous for the entity. This imposes the orientation of the internal audit department's activity is set on the company's strategy, that has to be a preventive action, a continuous and to the subject.

### 2. Research methodology

Generally speaking, the added value is a way to express the economic-financial performance and measures the plus that are obtained from the production activity. It measures the supplement of economic value created by the production and it is equal to the difference between the production

value and the value of the assets and services destroyed or transformed during the production process.

"Added value" is a concept that finds its origin in the macro-economic analysis; it belongs to the national accounting and is related to the production concept. Economically, the production is the activity performed under the control and responsibility of an institution (trade company, individual company, public administration or non-profit institution), that uses capital inflows, labour, goods and services to produce goods and services.

The value added concept has different approaches. An important distinction has as criteria the type of resources the added value comes from: the commercial production or the non-commercial activity. A production is considered commercial if sold at an important price from an economic point of view. A production (activity) is non-commercial is provided for free or at a price which is not significant from an economic point of view: it belongs to public administration field and to non-profit institutions that belong to households (C. Jessua s.a., 2006, p. 935 – 936).

In the internal audit activity, the added value concept is a controversial one. It is difficult to find an approach globally accepted that fits to each entity no matter the economic, social and cultural environment. The internal audit is different from country to country and from one organization to the other. Thus, there are situations when some internal audit practices may be considered as value added providers for the organization, while at the same time the same practices for another organization may be resources consumer (C., Bota-Avram, 2008, p. 4).

The special literature mentions that the internal audit departments are concentrated on their role as a reviser and independent valuator of the efficiency of the internal controls and the financial health of the organization. Compbell M. considers that the internal audit departments as a result of the Sarbanes-oxley law from 2002 must provide more value to the organizations where they function.

In their view, the internal audit departments must adopt an approach centred on the audit's client that will provide value and ensure a continuous dialogue with all the departments of the organization.

Another approach supposes to be taken into consideration the points of view of all parties interested inside the organization. Thus in 2003, IIA led a study entitled "Value added services of Internal auditing", and the results of this study show that more than 52% of the interviewed ones needed to make significant changes in the internal auditing practice to provide more value to the organizations. Because the interested parties inside the organization are not totally aware of the internal auditing responsibility we consider that the internal auditors must explain the role of the internal auditing in adding value inside the organization.

### **3. Problems to determine added value by the internal auditing**

The diversity of conceptual approaches of the added value is due to the particularities that materialized the internal auditing function from one organization to the other. At the same time, it is necessary to take into consideration the fact that the activity of internal auditing must comply with the conceptual framework promoted by IIA, through the International Standards of Internal Auditing, their compliance being compulsory; they do not have a recommendation character.

A significant influence on quality and quantity of the added value created by the internal auditors has the following premises and factors:

- Knowing the depth of the organization;
- Knowing the practices of internal auditor and the formation of added value in this activity;
- The courage to innovate and to adapt the innovations to the organizations' conditions (V., Emil, 2007, p. 61).

These premises and factors have been identified by Roth J. that after research mentions that an ideal department of internal auditing must have the following characteristics:

- The personnel inside the department must have the experience of such an activity;
- A challenging labour environment;
- Alignment form an organizational point of view to the best practices in this field;

- Valuating the quality risks and providing solutions in real time;
- A matrix approach of the audit services.

In studying the ways to provide added value by the internal auditing another category of identifying the determinants factors has been identified:

- Improving labour productivity;
- Reducing costs related to the internal auditing function;
- Adopting more efficient audit techniques;
- Reprojecting the audit plan is necessary in order to obtain a better efficiency;
- Eliminating the useless projects, the outdated ones (C., Dobroteanu, L. Dobroteanu, 2007);
- Continuous improvements of the competences;
- Issuing recommendations that added value by improving the audited activities.

In order to issue recommendations that really generate value, Walz A. (1997) identified the following relevant guidance the auditors must take into consideration:

- The auditors must be a support to create value and must not prevent the activity that creates value;
- Promote positive changes, and the recommendations made by the audit department should not be destructive, on the contrary they must favour the creation of value;
- To be oriented towards the future because preventing a situation that generates difficulties is easier than treating an existing problem in the entity's activity;
- To provide improvements to help the organization to be more competitive in her field;

The added value provided by the internal auditing gains more and more relevance in nowadays economic conditions and this imposes the identification and quantification of the determining factors in the entity's performance.

The question that becomes more and more often is "How could the internal auditing contribute to the improvement of the efficiency and the risk management, the control and the governance processes?"

Meeting these objectives is based on the management and analysis of the risks. At the moment the managers do not give a sufficient attention on valuating their own risks, their activity is empiric. They do not take into consideration the activity of the auditors and the good practices recognized in this field. The entities have not created systems to identify potential risks in an early stage, possibility given by the existence of a system warning over the risks.

The good international practice in the field considers that the managers and internal auditors that work together in valuation of the entity's risks and reorganization of the managerial control system could obtain a higher added value from the internal auditing.

The head of departments of the internal auditing valuate the value the organizations provided by a serial of indicators:

- the quality of the findings and recommendations made available for the managers;
- issuing reports on time and their quality;
- presenting reports to the administrative committee or the audit committee;
- analyzing the satisfaction forms of the clients and beneficiaries;
- the position of the internal auditing department inside the organization;
- savings and higher efficiency due to the internal auditing.

The entities must analyse the efficiency of their own internal auditing departments and must make sure that they are equipped properly in order to fulfil their tasks. Therefore the internal auditing departments must established measuring systems in order to prove that they perform activities in a proper way. In order to prove that the internal auditing adds value, the internal auditors can count the financial benefits produced by the managers of different departments following the changes in their activity as a result of the recommendations brought by the internal auditing. These may refer to: updating some internal control activities, improvement of the working procedures, proposals of reducing the expenses, changing the suppliers, etc.

The contribution of the internal auditing under the form of added value can be measures by valuating the financial impact on the entity in the future period.

Inside the entity there is used a method of measure the performances of the internal auditing department "Synoptic score tables". This is an instrument of the internal auditing that allows the alignment of the internal auditing with the organizational objectives by the management of the strategic performances. With its help the internal auditing department delimited the main fields where an added value may be brought to the entity and includes the function of the audit over the financial performance of the organization.

After the consultation with the Audit Committee, the internal auditing department must define the main purposes for each of the entity's fields of activity where an added value is brought and established their objectives and way to improve them. Because each organization has unique objectives and the synoptic table is unique.

In UK and Northern Ireland, II A describes the way of using the "Synoptic score table" to measure the performances of the internal auditing and it identified six main themes:

- determine how by measuring the performances of internal auditing reflect on the function of the internal auditing;
- verify if there are faster cashing indicators of the debts, and later payments of the debts;
- examine the efficiency of measuring the performances of the internal auditing departments in the operational strategy;
- ensure that the different sides measured for the entity's performance are understood and administrated accordingly;
- value how measuring the performance reflects the proposal to increase the added value by the internal auditing;
- determine if measuring the performances supports the strategic role of the internal auditing inside the organization.

To develop a frame inside the synoptic score table for the internal auditing the following stages must be fulfilled:

- the chiefs of the internal auditing must make a SWOT analysis to evaluate the hard and weak points of the department;
- concentrate on strategic development themes;
- identify the length of different sides measured for the performance related to the strategic objectives established;
- a continuous valuation of the use and efficiency of the synoptic score table.

In the internal auditing there have been developed also some other approaches in order to show the management that they provide added value, to value their performance compared to other similar entities. Therefore the internal auditing must have measuring methods of the accomplished performance to demonstrate they add value to the organization.

#### **4. Conclusions**

The main objective of the internal auditing is to supply the management team of the organization with an independent opinion and an objective one over the internal control and the management system.

The internal auditing contributes to a rigorous management of the resources, to the increase of performance of policies implementation, programs and actions established by identifying the risks and finding corresponding solutions.

The audit should focus on assessing the managerial capacity to achieve organizational goals, to determine the extent to which the managerial decisions are appropriate to achievement of their objectives and how they are achieved.

The contribution of the internal auditing department to create added value is possible by the use of suitable instruments to take into consideration the specific activity developed by each entity.

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