

MEASURING AND ASSESSMENT OF INTERNAL AUDIT'S EFFECTIVENESS

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The evolution of internal auditing in the last period was a very dynamic one, being affected by the increasing attention for its role in corporate governance, especially because of its links with internal control and risk management systems. Internal auditors had to extend their area of actions, becoming more involved in risk management, control and governance processes. In the light of these changes, new concepts begins to be more and more in the center of attention, the added value by internal audit to organizations and its effectiveness. In order to determine the efficiency and effectiveness of internal audit, it becomes more and more important to find relevant methods for measuring and assessment the performances obtained in assuring a plus of value. Our main purpose in this paper is to identify the most significant types of methods used in determining the performance of internal audit by using the fundamental type of research.

Keywords: value added, internal audit's effectiveness, qualitative methods, quantitative methods, balanced scorecard

JEL Classifications: M21, M40, M42

1. Introduction

Even if the internal audit function is an integral part of the control framework of an organization, it is obviously that this function also must have its own control, to track whether its performance is consistent with its role and objectives. International Standards for the Professional Practice of Internal Audit⁴¹⁷ states that “*The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity*” (1300-Quality Assurance and Improvement Program). According to the interpretation offered by the new version of internal audit standards issued by The Institute of Internal Auditors in 2008 and applicable with 2009 “*this program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement*”.

In this context, the problematic of measuring the effectiveness of internal audit function receive increasingly significant valences so that internal audit has to face a significant challenge consisting in finding the best and relevant method for measuring the efficiency and effectiveness of internal audit and quantifying the progress made in achieving its goals and objectives⁴¹⁸. Internal audit must find answers to difficult question like: *Which method of assessing and measuring internal audit's performance is more effective and relevant?*

Added value delivered by internal audit become more and more relevant, which makes quite necessary to identify the determinant factors in creating this added value. We appreciate that in the next future one of the most important criterions for the existence of internal audit will be creating value that will determine the existing reason for internal audit profession. Internal audit must become a “*value creator*” trying to eliminate the unpleasant label of “*resources consumer*”.

417 Institute of Internal Auditors – IIA, "International Standards for the Professional Practice of Internal Auditing", Octombrie 2008, available on-line at <http://www.theiia.org/guidance/standards-and-guidance/ippf/standards/>

418 Prawitt, D.F., (2003), “Managing the internal audit function” The Institute of Internal Auditors Research Foundation, accesibil on-line la www.theiia.org

We consider there are few general rules that internal auditors must respect in order to give their contribution at the organization's progress:

-Internal auditor must be aware over his responsibility regarding the creating of value added for the organizations;

-It is internal auditor's responsibility to show the management and the audit committee how internal audit works;

-Internal auditors must have the chance to train the management by organizing sessions regarding the self evaluations over the controls within the organizations⁴¹⁹.

2. Research methodology

Our research methodology is based on fundamental research, trying to gather the main important findings from literature regarding the researched area. This paper is focused on analyzing the information provided by specialty literature by documentation and observation methods, in order to be able to offer some certain guidelines for the measuring and assessment of internal audit effectiveness. Of course, beside inductive research method, it was also used deductive research method, which has a significant role in determination process of the research's results. In the first phase, our intention was to offer a general overview of the most important techniques used for the evaluating of the performance of internal audit function, by investigating significant studies in the research domain. Next, we try to synthesize the most relevant methods trying to build a framework with the important guidelines that could be used in assessment of internal audit's effectiveness.

3. Literature review in the researched area

Starting from the premise that it is quite relevant to identify which are the most used methods in measuring and assessment of internal audit's effectiveness in international internal audit practices, we found very interesting the results obtained by one of Big Four audit firms, exactly Ernst&Young, from 2007 and 2008, so called "Global Internal Audit Survey". The report "*Global Internal Audit Survey 2007*"⁴²⁰ highlights the findings of survey made through internal audit executives representing 138 predominately public companies representing membership in the Global Business Week 1000, and the Standard&Poor's Global 1200 from 24 countries, most of the participants' companies being large multinational functions with revenues over US\$ 4 billion. Surprisingly this survey shows that half of the respondents do not track the value their internal audit function provide to the organization, while only 13% measure value based upon actual cost savings. The importance of value tracking is given by the fact that reinforces internal audit's relevance as well as help to justify the investment in necessary resources for internal audit. Testing the methods and techniques used to measure and assess the performance of internal audit, the findings of this survey showed that:

-the top metrics used in measuring internal audit effectiveness are: completed internal audits in comparison to the internal audit plan (89%); and the length of time for issuing internal audit reports (72%);

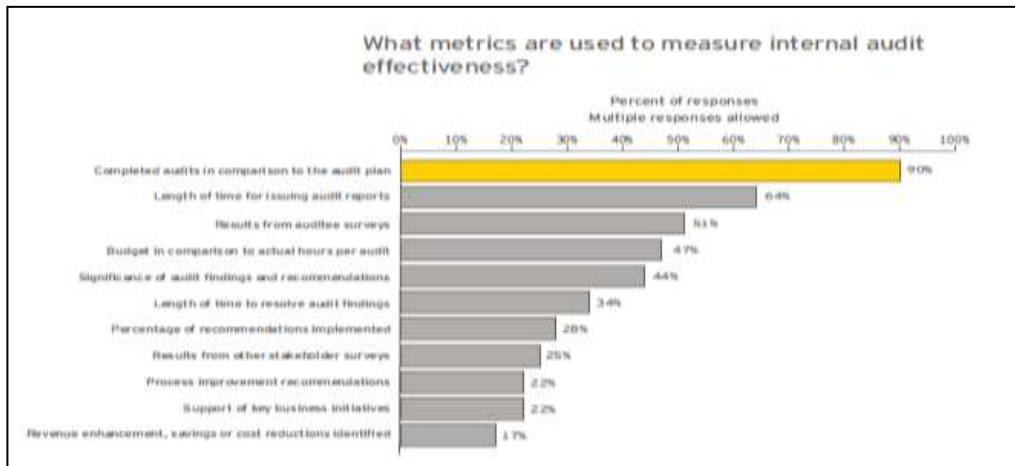
-only 32% of respondents use length of time for resolve internal audit findings as a key metric, while 23% use support of key business initiatives.

419 Gross, J.A., (2006), "Control consciousness: internal auditors need to use their knowledge and experience to provide innovative methods of adding value", *The Internal Auditor*, April, accesibil on-line la http://findarticles.com/p/articles/mi_m4153/is_2_63/ai_n16134043

420 Ernst&Young, (2007), „Global Internal Audit Survey, A current state analysis with insights into future trends and leading practices”, accesibil on-line at www.theiaa.org/download.cfm?file=31923

The survey “*Global Internal Audit Survey 2008*”⁴²¹ highlights that beside top metrics (identified in 2007 survey) used in measuring internal audit effectiveness: completed internal audits in comparison to the internal audit plan and the length of time for issuing internal audit reports, there is one more frequently used namely the results from shareholders surveys. The survey from 2008 found that only 34% of respondents use length of time to resolve internal audit findings and only 22% use support of key business initiatives as a key metric. According to Ernst&Young Survey from 2008, the most used methods to measure internal audit effectiveness are presented in Figure no.1

Figure no.1 Methods used in measuring internal audit effectiveness



Source: Ernst&Young, 2008

The study realized by PROTIVITI (one of the largest providers of internal audit services and consultancy from United States and Canada) in cooperation with The Institute of Internal Auditors⁴²², that was focused on testing the best internal audit practices from some big multinational companies from entire world shows that **the measuring and the enhancing of the internal audit’ performances are some of the main preoccupations of the internal audit managers from analyzed companies**, and the main modalities to assure the quality are:

- instituting of assurance quality departments under the coordination of assurance manager responsible for the obtaining of a reasonable degree of assurance that internal audit from whole company applies politics and procedures according to the internal audit standards;
- realizing of internal audit quality audits according to the settlements of internal audit standards issued by IIA and initiating of some programs of assurance quality in cooperation with IIA headquarters within the countries companies are from;
- evaluations of internal audit quality realized by external teams in order to verify the compliance with internal audit standards, and also there used some instruments for the measuring of internal audit performances like Balanced Scorecard;
- measuring the performances through qualitative methods by realizing of some satisfaction studies for the clients of internal audit, one main objective being the identifying of the potential causes for the unhappiness of the client;

421 Ernst&Young, (2008), “Escalating the role of internal audit”, Ernst&Young Global Internal Audit Survey, 2008, accessible on-line at http://www.ey.com/global/content.nsf/International/AABS_-_Advisory_-_Escalating_the_role_of_internal_audit

422 Protivi Knowledgeleader, (2005), „Internal auditing around the world, Profiles of Internal Audit Functions at Leading International Companies”, Protivi Knowledgeleader, accessible on-line la www.knowledgeleader.com June, Vol. I

-implementation of some assurance quality programs and the accountability to realize annual assessments of internal audit quality;

-other instruments used for the measuring of the internal audit's effectiveness are: informal reports for the management, different monitoring systems of a necessary time for fulfilling the audit missions and the quality of internal audit reports, the contribution of the chief internal audit executive at the developing of the new internal audit procedures and the compliance of the specific objectives for each internal auditor.

4. Guidelines in measuring and assessment of internal audit's effectiveness

Trying to identify the relevant guidelines in measuring and assessment of the internal audit's effectiveness, we appreciated that the classification of methods used should be made from two perspectives: quantitative and qualitative.

A. Quantitative methods for the measuring of the internal audit's effectiveness

1. Determination of fulfilling degree of internal audit plan that consist in establishing the proportion that internal audit activities are realized according to internal audit plan in a certain period of time. This can be measured by determining the number of realized activities reported at certain planning period time for each type of activity.

2. Identification of necessary period of time for the issuing of the final internal audit report that consists in determination of the passed time from ending internal audit work to the issuing of final internal audit report, including the plan of actions for the management;

3. Monitoring the necessary period of time for the solving of audit findings that supposes to look for the period of time necessary for the solving of internal audit findings. From this point of view we consider very pertinent *to realize a statistical data base through to be followed different elements like the number of deficiencies solved in established time, the number of deficiencies solved with delay and the number of deficiencies unsolved;*

4. The assessment of personal's certification: from quantitative point of view, that can be determined through the number of staff employees from internal audit department with professional certification diplomas or the professional experience quantified in years of internal audit work;

5. Determination of the report between time dedicated for certain internal audit activities and the time dedicated for administrative activities that can be determined through daily monitoring of each internal auditor's time by clearly specifying of types of activities realized during a day of work.

B. Qualitative methods for the assessment of internal audit's performance

Analyzed from qualitative point of view, the most frequent methods for the assessment of the internal audit's performance are:

-*Fulfilling of some studies (questionnaires or interviews)* next to the ending of the internal audit missions and the respondents to be the organization managers.

-*Fulfilling of some studies (questionnaires or interviews)* next to the ending of the internal audit missions and the respondents to be the auditees.

The elements of these questionnaires could be different from one organization to another, being influenced by the vision of each manager, but also by the opinion of the auditees regarding the ways that internal audit could deliver more added value. Next, we try to build a model of questionnaire regarding the assessment of internal audit's performance from the perspective of the auditees, without having the pretention of being exhaustive, in the same time, being convinced that it could be enhanced by taking in consideration the specific of each organization. Of course, starting from the same principles, it could be developed another questionnaire from the perspective of managers, by taking in consideration their criterions in evaluation the added value, these criterions could be different from the one followed by the auditees.

Table no.1 A model for the assessment of internal audit’s effectiveness from the perspectives of audittees

Because of internal audit preoccupation for the continuing improving of the quality of offered services, please fill next questionnaire taking in consideration the last internal audit mission that you participate as an audittee.

Internal audit missions that had been participated..... Name.....
 Internal auditors participants at referring mission:..... Date.....
 Function within the organization.....

Please tick off only one answer, using 1 to 5 scale, where 1 – total disagreement and 5- total agreement.

General expectations from internal audit	1	2	3	4
1. Do you consider that internal audit deliver added value to your department?				
2. Do you consider that internal audit improve the activity from your department?				
3. Do you consider that internal audit help you in assuring the premises for next projects?				
4. Which is your general opinion regarding the internal audit’s effectiveness for the whole organization?				
Assessment of internal audit work	1	2	3	4
5. Do you consider that established objectives at the beginning of audit mission were accomplished?				
6. Do you consider that communication between internal audit and external audit was efficient?				
7. Do you appreciate that audit work was efficiently performed according to planning period?				
8. Do you consider that internal audit work was realized with responsibility?				
9. Do you appreciate that findings are correctly argued and justified?				
10. Do you appreciate that internal audit recommendations are significant?				
11. Do you consider that internal audit report was issued in a useful time?				
12. Do you consider that internal audit report is clear and logical?				
Assessment of internal audit teamwork	1	2	3	4
13. Do you appreciate that internal audit teamwork had been proven that has necessary knowledge in audited area?				
14. Do you consider that internal auditors were professionals?				
15. Do you appreciate that internal audit team was proactive?				
16. Do you appreciate that internal audit team had been focused on essential elements?				
17. Do you consider that internal audit had been developed a good cooperation between auditors and audittees?				
18. Which were the most positive aspects that you appreciate as a result of internal audit work?				
19. Which were the most negative aspects that you dislike as a result of internal audit mission?				
20. Please, other comments.....				

Thank you for your time and the honesty of your answers

Source: projection made by authors

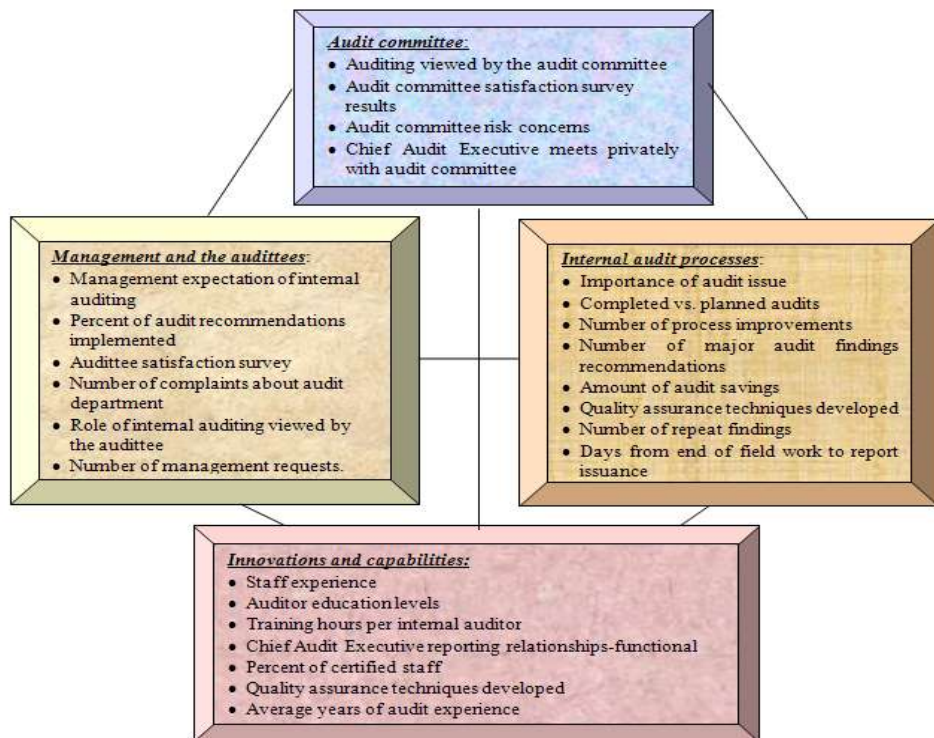
C. Methods of measuring and assessment of the internal audit performances that combine quantitative with qualitative elements

One of the most interesting methods that combine quantitative with qualitative elements is the one that uses the “*Balanced Scorecard*” instrument. Lately, the importance and frequency of using this instrument become more and more obviously, a fact confirmed also by the

international specialists from international literature⁴²³, but also a fact confirmed by the practice of many multinational companies.

Frigo M.L. had a significant contribution at the researching of the results obtained by using of Balanced Scorecard instrument in the evaluating of the performances of an internal audit department through his paper totally dedicated to this problematic - „A Balance Scorecard Framework for Internal Auditing Departments (Paperback)” – a paper realized in cooperation with *The Institute of Internal Auditors Research Foundation*. The author of this study wanted to develop a model of Balanced Scorecard for internal audit departments, following to emphasize the ways that internal audit departments could improve their activities regarding the measuring of internal audit performances. The Balanced Scorecard model presented by Frigo M.L. is approached from few key elements perspectives like: (1) internal audit customers (audit committee, management and the auditees); (2) internal audit process; (3) innovations and capabilities. For the construction of this model, the author starts from the premise that there are some key concept of this model that could be applied for the internal audit departments: *measuring the performance from customer’s point of view; determination of some certain indicators for the quantifying of the internal audit performance; the connection between internal audit and customer’ expectation; focusing on general strategies of the department; innovation and capabilities of internal audit.*

Figure no.2. Balanced Scorecard model for internal audit function



5. Conclusions

In today’s turbulent economy it is clear that internal auditors have to face with difficult challenges, one of them being the one of proving its relevance and necessity within the organization. In this context, the added value delivered by internal audit becomes more and more

423 Frigo, M.L., (2002), „A Balance Scorecard Framework for Internal Auditing Departments (Paperback)”, The Institute of Internal Auditors Research Foundation, Altamonte Springs, Florida

important, internal auditors being more and more interested to find the most relevant methods for measuring and assessment of internal audit's effectiveness and efficiency. There are many methods and instruments that could combine qualitative with quantitative elements. In our opinion, the choice of used method depends on the settlement of the main objective of trying to obtain the best reflection of internal audit's relevancy and efficiency, offering arguments for investment for necessary resources in order to obtain a good developing of internal audit department.

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