THE IMPORTANCE OF PERFORMANCE AUDIT AND RISK FORECASTING

Alice STEFANESCU
Bucharest University of Economic Studies, Bucharest, Romania
alicestefanescu@yahoo.com

Monica TRICULESCU
Bucharest University of Economic Studies, Bucharest, Romania
monica.triculescu@man.ase.ro

Abstract
Effective business operations are the result of correct implementation and coordination of resources for the pursuit of business objectives. Organizations exist to reach a goal, and the processes are designed for this purpose. These processes are in turn staffed by people whose number and set of skills contribute to the fulfillment and are assisted by technology or machines. As a result, success is the outcome of proper planning and effective alignment of people, processes and technology. This article highlights the necessary steps, thought processes and risks involved in running a successful organization, and all the aspects included in the concept of "performance".
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1. INTRODUCTION

Economic, financial and technological changes, the globalization and increase of the competition are the challenges which organizations must learn to manage today. More than ever, companies must implement new tools in order to achieve a level of performance that will allow them to "survive" in an increasing and demanding environment.

Performance is a concept of many aspects, which does not only refer to the economic or financial side, but is above all social, and in this day the emphasis is more and more on the contribution of human resources management to organizational performance.

The old concepts based on the technological ensemble or the systematic reduction of the labor force have shown their limits over time. C.H. Besseyre des Horts (1988) qualifies the human resource as "the only resource that differentiates the successful organization from the non -performing one. Anything else can be bought, learned or copied."

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2. OPERATIONAL AUDIT

The term "audit" comes from the Latin verb "audire", which means, "to hear". Audit is as old as accounting and there are signs of its existence in all ancient cultures, such as Mesopotamia, Greece, Egypt, Roman Empire and India. Public responsibility represents one of the foundation of democracy. This has been recognized since the fourth century BC, when in Athens there were well-established procedures for keeping public officials liable for their actions and constant inquiries regarding their ability to lead. Recently, auditing has begun to include non-financial fields, such as safety, security, information system and environmental concerns. (Hay, 2014)

According to ISSAI, there are 3 basic types of audit: financial audit, compliance audit and performance audit.

Operational audit is defined as "a future-oriented, systematic and independent assessment of organizational activities. Financial data can be used, but primary sources of evidence are operational policies and achievements related to organizational objectives. Internal controls and efficiency can be evaluated during this type of review." (Murdock, 2022). Waring and Morgan (2007) define performance audit as follows: "Performance audit is a systematic, objective evaluation of the achievements or processes of a program or governmental activity in order to determine its efficiency, economy or efficiency."

Another definition is offered by Marin (2011), according to whom the operational audit, also known as performance audit, represents a systematic review of the activities of an organization in correlation with the objectives established beforehand, in order to evaluate the performance of the organization.

Performance audit delivers added value in the following ways:

- by providing new analytical information;
- making existing information more accessible to the different interested parts;
- by providing an independent and competent opinion or a conclusion based on the audit evidence;
- by putting together recommendations based on the analysis of audit findings. (INTOSAI)

Operational auditors audit for the "three Es" - efficacy, efficiency and economy. They seek opportunities for business processes to be performed differently, in order to improve their efficiency, efficiency and economy. Often the distinctive character between each of these "three E" is difficult to recognize, with the risk that the auditors will not approach all three. (Chambers, 2010)

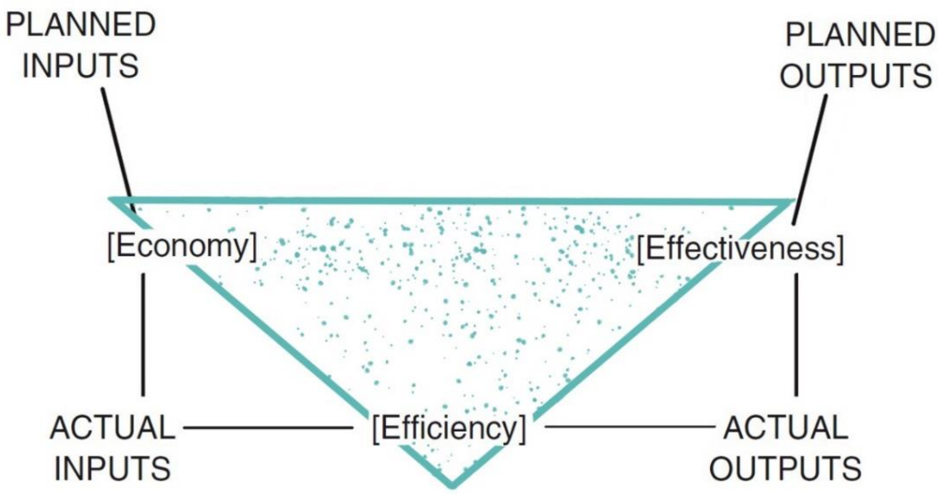

FIGURE 1. THE „THREE ES"

Source: The Operational Auditing Handbook (Chambers, 2010)

Economy is best established by following the ratio between the anticipated expenses for each resource unit of a certain quality and the real expenses. The audit of the economicity of administrative activities is carried out according to management policies and healthy administrative principles and practices.

Each organization (either a production or service entity) and each function or process within an organization has conversion processes that transform the real inputs available into real outputs. If the staff is poorly prepared, incompetent, poorly motivated or poorly supervised, it will be likely that the ratio between usable outputs and the actual resources introduced in the conversion process is unsatisfactory: in other words, we do not have an adequately *efficient* solution for the process of conversion. The audit of the efficiency of the use of resources (human, financial and other), includes regulations regarding the measurement and monitoring of the evolution of performance indicators, examining the information systems, as well as examining the procedures used by the audited organizations, in order to remedy the identified deficiencies.

Not only the quality of the staff is a factor that contributes - the design of the processes, the quality of the technology, etc are other factors. *Effectiveness* measures whether the real outputs correspond to the results that were planned. The audit of the efficacy of performance refers to the achievement of the objectives by the audited organizations, as well as the audit of the real impact of the activities of the entities, compared to the planned impact.

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In other words:

• Economy - means "doing things cheap" - for example, the unitary costs of the labor, materials, etc. being under control. Economy is the ratio between the planned inputs and the actual inputs in terms of unitary costs for a certain quality.

• Efficiency - means "doing things well" - for example with good systems that avoid waste and repression. Efficiency is the ratio between real entrances and real outputs. Each organization, whether it is a service organization or a production business, has such a conversion process.

• Effectiveness - means "doing the right things" - that is, achieving the goals. Effectiveness is the ratio between the real results and the planned results (ie the planned objectives).

To avoid under-achieving by setting goals that are too modest, the following tools can be used:

• Comparison with other organizations - to determine if the organization is "sufficiently economical", "sufficiently efficient" and "sufficiently effective";

• Comparison with other branches of the organization;

• Measurement and interpretation of trends over time;

• Targeting continuous improvement.

The “three Es” can be linked together, and recently another "three Es" have been added in the portfolio audit scopes, as a result of their role in the audit of the governance processes, as established in standards 2110 of the IIA:

• Equity - avoiding discrimination and inequity; accepting and promoting diversity

• Environment - acting in a responsible way to the environment

• Ethics - legal and moral conduct of management and staff.

3. PERFORMANCE MEASUREMENT

Organizations are likely to have in place a series of key performance measures, in order to, among other things, evaluate the achievement of their goals and objectives, evaluate their progress and compare relative performance (for example, over time). The nature and form of such measures will, undoubtedly, vary between the types of organization and, indeed, specialized forms of measurement can be applied in certain industries or sectors. However, there are a number of general measures of efficacy, efficiency and economy that are considered universal. Measurement methods can be applied to identify whether there is an initial improvement potential and then used later to monitor the required levels of performance. The need to apply efficient and realistic methods of performance measurement is often generated as a by -product of fundamental processes of change in which, for example, an organization reorients its strategy and position.

During a revision of an operational area, the auditor often faces the need either to place the findings of the review in an adequate context, or to indicate the performance of the field analyzed in relation to the criteria previously established by the management. In most cases, it is preferable to use the standards and measurement criteria implemented by management, as the outcome is that the auditor uses a common and compatible language when communicating the results and points of interest.

By contrast, if the auditor chooses to use a new, alternative or perhaps radical form of measurement of performance, this can influence the perspective of the organization's leaders on the auditor's findings. However, this does not mean that auditors should only adopt the measurement criteria established by the management, as in some cases there may be a reason for the introduction of another objective form of performance evaluation.

Whatever the form of measurement applied, its use must be based on both exact and reliable data and on a proven method, otherwise the credibility of the audit will suffer.

In using performance measurement, auditors should be careful that leadership does not replace or misinterpret the criteria. On one hand, it can be legitimate for an auditor to investigate the lack of a response by top management to a negative measurement indicator, but this does not necessarily mean that management has abdicated its basic responsibility for monitoring and control. This emphasizes a basic truism, in the sense that the measurement data is provided for interpretation and, unless there is a formal measurement protocol in force, there may be the possibility to draw different conclusions from the same data. This emphasizes the importance of officially establishing, at the organization level, a policy and a performance measurement, so that everyone involved is clear about the nature of the data and how to use it in practice. In addition, establishing and communicating the organization's goals and objectives can eliminate (or at least limit) a part of the ambiguity associated with the necessary performance level and the expected level of associated achievement.

4. EXAMPLES OF PERFORMANCE MEASUREMENTS

When the performance measurements are established, it is logical for them to be structured on a hierarchical basis, the macro level indicators being divided into more detailed measures (at micro level) regarding specific fields or subdivisions of the operations or of the organization. According to Chambers (2010), this must be taken into account when considering the following examples of performance measurements.

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1. Workload/Demand performance measurements - indicates the volume of production, whether it refers to services, products or others and, when related to resources input measurements, provides useful information on quality or quantity issues.

Examples:

- Number of users
- Number of units produced
- Number of books in a library
- Percentage of first-class diplomas in a university.

2. Economy performance measurements - they can highlight the waste in providing resources, indicating that the same resources can be provided cheaper or that more businesses can be driven at the same cost.

Examples:

- The cost of actual input compared to the planned input
- Cleaning costs for an hour worked
- Maintenance costs per unit surface
- The cost of financing function to 100 employees
- The cost of the executive director's department per 1000 customers.

3. Efficiency performance measurements - these can highlight potential opportunities to convert the resources to the final product with fewer residues. Many performance measures will indicate either non-economic or inefficient practices, or both. Often the distinction between one and the other cannot be made.

Examples:

- Ratio of real input to real output
- Breakdown per day of production
- Work accidents per 1000 employees

4. Effectiveness performance measurements - these performance measures focus on how the objectives are achieved - regardless of economy, efficiency or equity (unless the objectives are specifically refined to economy, efficiency and equity).

Examples:

- Real output compared to planned output
- Degree success (in a Faculty or University)
- Research output per 100 people employed in research
- Ratio between customer complaints and sales.

5. Equity performance measurements - these performance measures draw attention to inequity or potential social irresponsibility in terms of corporate policy and practice.

Examples:

• Number of library books per user category

• The proportion of women employed

• The proportion of employees with disabilities

5. RISK

The management of the risk in enterprise is a process carried out by the Board of Directors of an entity, management and other personnel, applied in establishing the strategy and throughout the enterprise, designed to identify potential events that may affect the entity and to manage the risk to be within the limits of appetite for risk. to provide reasonable insurance regarding the achievement of the entity's objectives.

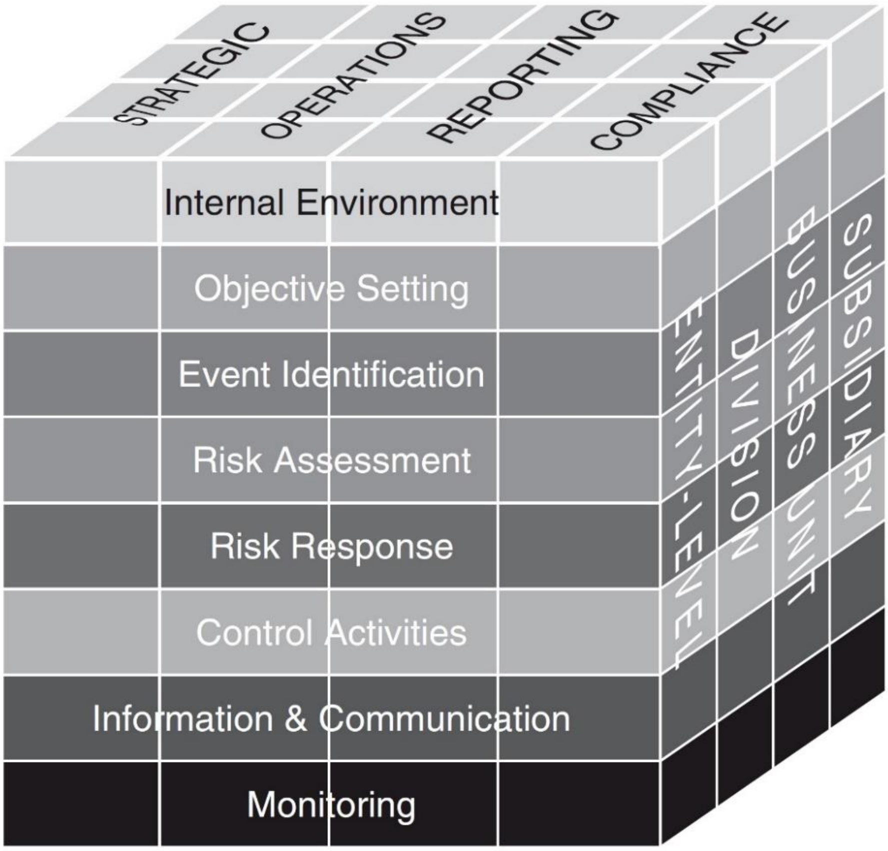

FIGURE 2. THE „RUBIK CUBE" OF ENTERPRISE RISK MANAGEMENT

Source: Committee of Sponsoring Organizations

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Risk, according to Marin (2011), represents any event, action, situation or behaviour with unfavourable impact on the ability of the audited entity to achieve the objectives.

Risk analysis represents a major stage in the audit process that has two purposes:

a. Identifying dangers in the audited entity (if the internal / external controls or the procedures of the audited entity can prevent, eliminate or minimize the dangers)

b. Evaluation of the evolution of internal / external control of the audited entity

According to COSO, the risk management framework is oriented towards achieving the objectives of an entity, presented in four categories:

• Strategic - high-level goals, aligned and supporting its mission

• Operational - efficient and efficient use of its resources

• Reporting - reliability of documents and reporting

• Compliance - conformity with applicable laws and regulations.

Internal audit is an efficient managerial control tool and is frequently superposed with carrying out an operational audit. Although sometimes limited to auditing the financial situation, the evaluation of operations in general can be included. Thus, the auditors can evaluate the policies, the procedures, the quality of the management, the effectiveness of the methods, and possible special problems.

COSO (2004) identifies eight essential components that must be implemented and working effectively for risk management to be effective. They are summarized on the front of the "Rubik cube" of the risk management of the COSO company, in Figure 2.

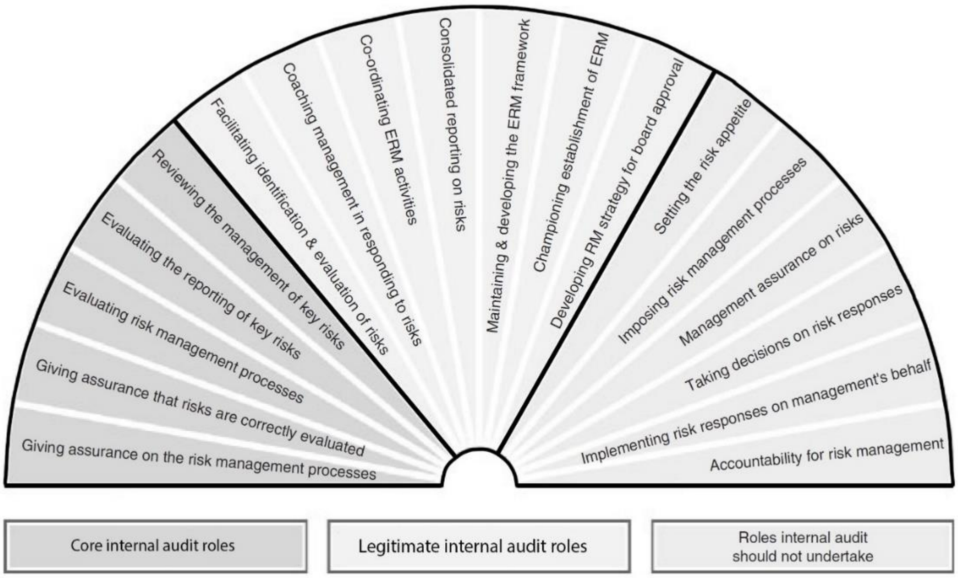

FIGURE 3. ROLE OF INTERNAL AUDIT IN ENTERPRISE-WIDE RISK MANAGEMENT

Source: “Position Statement: The Role of Internal Audit in Enterprise-Wide Risk Management” (I.I.A.)

Engaging in a risk-based audit means that auditors must exercise and apply a wider vision on organizational risks. Accounting and financial risks are just a limited part of the many risks that organizations face. Other examples include the risk of delays, waste, inefficiency, poor customer services, excessive fluctuation of customers and employees, poor quality data and system failures. (Murdock, 2022)

There are a number of enterprise risk management activities. Some of them fall in the role of insurance of the internal auditor, and others in its consulting role, while others are the responsibility of the management and should not be undertaken by the internal audit, as seen in Figure 3. (I.I.A., 2008)

The task of the auditor is to obtain sufficient adequate audit evidence for the audit opinion to be based on. The auditor has to reduce the risk of issuing a firm opinion based on information containing significant distortions or on internal control that has significant weaknesses.

While the auditor has to achieve sufficient appropriate evidence before issuing an opinion, determining what is "appropriate" and "sufficient" is not an easy task.

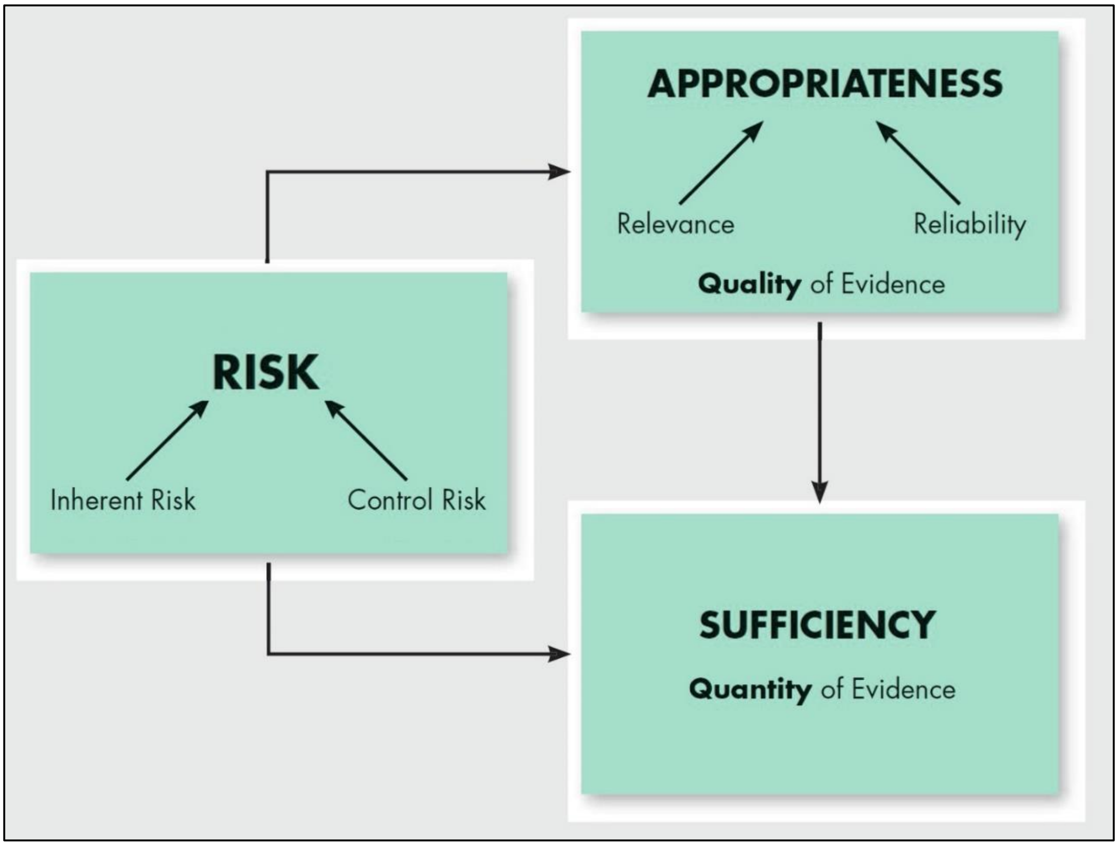

FIGURE 4. INTERRELATIONSHIP OF RISK AND EVIDENCE APPROPRIATENESS AND SUFFICIENCY

Source: “Auditing: A Risk-Based Approach to Conducting a Quality Audit” (Johnstone, 2014)

To determine if the audit samples are adequate, their quality must be established, including the relevance of the samples (if it offers a perspective on the validity of the tested assertion) and the reliability of the samples (if they are convincing). The relevance of the evidence refers to the connection between the audit procedure and the audited statement. The reliability of evidence is influenced by its source and nature and depends on the circumstances in which they are obtained.

6. CONCLUSIONS

Performance audit is an evolving field. The last decades have brought an unprecedented number of changes in the operational, technological, economic and social environment in which the organizations operate, and the auditors must answer accordingly. The necessary adaptation involves the redefinition of what we hear, how we hear, when we audit, who performs the audits and even where the audits are made. The unit and the organization are continuously strengthened by integrating performance data, worldwide leading practices, and feedback from performance audit, which is acknowledged as a critical change agent. Engaging in a risk-based audit means that auditors must exercise and apply a wider vision on organizational risks, since accounting and financial risks are just a limited part of the many risks that organizations face.

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