



REENGINEERING THE ORGANIZATION OF INTERNAL AUDIT IN MODERN ORGANIZATIONS

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Abstract: *Reengineering is a radical redesign of business processes, organization and mentality. The objective of reengineering is a quantitative leap of performance. In this context, we will analyze audit work through reengineering. We have designed this approach as a redesign and rethinking of audit activity and not just as an improvement in audit work. This paper proposes an approach to the applicable marketing auditing in industrial enterprises. It is a guide to good practice resulting from the analysis of companies in Serbia and Romania*

Keywords: *reengineering, audit, business*

1. Introduction General considerations on the audit of marketing

The risk is uncertainty. It appears due to the lack of information, while the certitude grows due to information. The audit is a process that works with evidence. To understand the risk of the audit, the auditors must understand the incertitude. The incertitude appears when the information is insufficient and this may happen in many cases. The marketing analysis or audit represents the most detailed process that can be performed by a company in order to know exactly its marketing activities. The examination is performed with the aim of determining the problems and the favourable occasions and for recommending in the end a plan of action to improve the activities of the company.

The marketing audit requires the systematic verification of the marketing capacity of the enterprise, based on a structured and unbiased evaluation of the environment and

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of the activities of the enterprise (Anghel, L.D., Petrescu, E., 2002). It is a periodical, extended, systematic and independent examination of the marketing environment, objectives, strategies and activities of the company – or of one of its strategic unit – performed with the aim to establish the domains of the problems and the favourable occasions and to recommend a plan of corrective action, destined to improve the performance of the company in the field of marketing. The term appeared in the 50's but developed intensely at the end of the 70's. The marketing audit grows in popularity especially for the company with a large variety of BSU (business Strategic Units), differing in their market orientation. It is a control and organisation activity, involving an analysis of the total marketing efforts of the enterprise. It has a large aim and covers a longer period of time than the sale and profit analysis. Its main aim is to collect information necessary for the identification of the strong point sand of the weak points of the enterprise, the opportunities and the threats from the external environment. It is more and more important for the management to pay attention to the marketing activity of the company. The marketing audit is a vehicle that helps for this.

Most of his time, the auditor collects data. The data include primary data and secondary data. When all the necessary data are collected, the auditor prepares and presents the results of the audit to the managers under the form of a report. Some auditors prefer to present the report only to the top manager, others insist to present it to the managers from all the hierarchical levels. *The role of the auditor* in this case is not to take decisions instead of the management, but to offer the strong points and the weak points from the marketing operations.

2. The reengineering of the organisation of the internal audit in the modern organisations

The reengineering represents the radical new design of the processes, of the organisation and of the mentality of an enterprise (Hammer, M., Champy, J 1996). The objective of the reengineering is a quantitative increase of the performance. We will analyse the audit activity in this context in terms of reengineering. We intended our approach as a new design and rethinking of the audit activity and not only as an improvement of this activity.

Nowadays, during the years of the economy of information, the creation of value depends on the effective use of the intellectual capital, with factors that include the knowledge, the personal relation and the intellectual property. The importance of these factors forces the managers to develop the innovation in the strategic planning. These new fields contributed to significant changes in the way the managers measure the success of the business. In the past, the managers used hard traditional measurements, as the recovery of the investment, the evaluation of the performance before the strategic planning, etc.

The system for the measurement of the performance is the instrument that helps the managers to monitor the performance of the business, to evaluate the degree in which the strategic objectives were achieved.

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Due to the importance of the intellectual capital in the present organisations is imperative to reinvent the design and the implementing of the measuring system, to highlight the contribution of the intangible factors as: knowledge, relations with the customers, and relations with the providers.

Drucker mentions the role of the intellectual capital for the creation of value as being crucial for obtaining the competitive advantage of the market: "Knowledge is the key to the economic resources and perhaps the only source of competitive advantage".

Researchers in the field of the audit, Catherine A. Usoff, Jay C. Thibodeau, and Priscilla Burnaby from the Department of Accountancy, Bentley College, Waltham, Massachusetts, USA, performed a study on some enterprises (Usoff, C., Thibodeau, J., Burnaby, P, 2002) Thus:

The first objectives of the study were to provide information on the possible connections between the size of the company, the industrial activity and the intellectual capital.

The second set of objectives aimed to investigate if the attitude toward the intellectual capital has any connection to the level of development of the measuring system of the business performance.

The research started from the following hypothesis:

Q1 Which distinct features are presented by those organisations that consider the intellectual capital to be very important and also by the companies that do not agree on its importance?

Q2 Which is the importance of the intellectual capital researched by the study and proposed in the system for the measuring of the performance of the organisation?

The measuring system of the performance of the business is an important mechanism for top managers for implementing the strategic objectives. The system monitors the progress in implementing the strategy analysing the differences between the present results and the optimal measured performance.

The objectives of the research:

Determining the importance of the intellectual capital in the business model of the company.

Following the manner the measurement of the performance attracts the contribution of the intellectual capital to the organisation process.

Determining the extension of the measurement of the performance in the past performance to the level of the organisation and of the departments.

The questionnaire was distributed to the internal auditors to a seminary organised by the "Institute of Internal Auditors", in March, 2000 in England. There were received 95 questionnaires from the participants and 54 of them were validated for the final analysis. In the case when several answers from the same organisation existed, there were validated those belonging to the people with the higher hierarchical rank or to the people with more

experience in the internal audit. This study provides data on the connection between the size of the company, the number of internal auditors, the level of the system for the measurement of the performance, the industrial field of activity and the attitude toward the importance of the intellectual capital (CI).

The results indicate the fact that the companies with larger departments of internal audit consider as very important the intellectual capital and that the companies with smaller audit departments do not give so much importance to the intellectual capital.

The analysis of the connection between the years of experience and the size of the department indicates the fact that the more experienced organisations also have an increased number of people in the department of audit.

The analysis of the data show that the work in the organisation varies depending on the field of the industrial activity. Thus, 20% of the respondents had an experience of 0-5 years and 28% had over 16 years of experience. 4% did not indicate their level of experience in the internal audit. 30% from 54 respondents had a certificate of internal auditor, 19% were certified as accountants and 6% were auditors in the system of information.

The size of the department for internal audit varied in our research: 52% had 1-9 people and 13% had over 40 people. The size of the researched organisations was as follows: 26% had a turnover between 250 million \$ and 1 billion \$, and 39 % had a turnover over 1 billion \$. 39 % organisations were international, 45 % local and 7 % national.

These results show that only the sophisticated companies considers much better to invest in the resources necessary to the management of the intellectual capital. The organisations must develop procedures for the attraction of the intellectual capital and the change of the traditional system for the measurement of the performance, according to the obtaining of the long term success (Quinn, J., Anderson, P., Finkelstein, S., 1996) . It is also necessary to direct more interest in the future to the research on the empiric determination of the value of the human resources placed effectively in the departments of internal audit.

3. Innovation and change in audit in modern organizations

Generally, the changes are inevitable and the aim of the management is to make changes for the good of the organisation.

How can we make this process as efficient and efficacious in the industrial companies?

It is a question we will try to respond to as follows.

It is necessary for the auditor to analyse the inputs and the qualitative results of the audit process and try to reduce the resources. There is a series of factors that are part of the substantial changes for a better internal audit and, in some cases, also contribute to the survival of the organisation.

These factors can be classified as follows:

a) Philosophical:

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- The vision and the mission of the company,
- Customer service,
- The control of the quality,
- The work of the audit committee.

b) Methodological:

- The inventory of the risk,
- The improvement of the communications,
- The decrease of the processing time,
- The use of the new methodologies,
- The measurement of the performance,
- The integration of the audit,
- The audit of the environment,
- E-business.

c) Operational:

- The improvement of the facilities,
- The highest possible innovation,
- The improvement of the management.

3.1 The work in the audit committee

It includes the relation between the organisation of the internal audit and the audit committee of the board of directors. The organisation of the internal audit can and must serve the committee with a double capacity: as a source for the functions of the committee and a source of intelligence for the management. The relative details of these two activities are:

a) The organisation of the services for the audit committee

- Providing the preparations of the information and training for the members;
- Determining the independence of the committee members;
- Assisting the committee for financial negligence and reporting activities;
- Assisting the committee in reporting to the shareholders.

b) The activities of the audit committee:

- Considering the risk of the business

- Determining adequately the internal control
- Ensuring the validity of the financial statement
- Accepting laws, certifying taxes, tolls and contracts
- Leading special investigations

These activities are an extension of the usual functions and add materiality to the value of the audit function of the organisation.

3.2 Aspects related to the consideration of the risk

The management of the risk is in close connection to: the financial risk, the risk of the marketing, the sensitivity of the risk and the objective risks.

The audit of the organisation cannot program the audit of the material risk in these fields. It is necessary to inventory the important fields of risk for the organisation, so the effort of the audit to be able to directed to these fields.

The factors that influence the risk are classified in two classes:

1) External factors:

- The technological development;
- The change in the needs and expectations of the consumers;
- Competition;
- The new legislation;
- Natural catastrophes;
- Economic changes.

2) Internal factors:

- The information system;
- The quality of the personnel;
- The changes in management;
- The nature of the activities;
- The efficacy of the scoreboard (TB).

More severe factors need to be added to the above presented factors:

- The quality of the system for the internal control;
- The liquidity;
- The complexity of the operations;
- The rapid growth.

These factors are the criteria used for identifying the possible conditions of individual factors or combinations in fields where they can have an adverse impact in the organisation. The auditors must evaluate the criterion that determines the place where the audit effort

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must be directed. Before taking this decision, the auditor must determine the risk with the highest priority.

Some considerations (Daignault, 1996):

- How much are the management and the audit preoccupied for this aspect?
- How is possible to change or improve the conditions?
- How bad is the situation?
- How important is this situation for the organisation?
- Which resources are available?

A new risk associated to the field, which must be considered by the internal auditors is the management of the risk. This concept can be sometimes organically advantageous for the organisation, e.g. the issuing of credit. *The auditor must determine the optimal risk but he must not eliminate the whole risk.*

Generally, the auditors describe the risk in terms of profitability.

The auditors admit three components of the risk in the model for the audit of the risk: *the inherent risk (IR)*, *the controlled risk (CR)* and *the detected risk (DR)* (*How to Evaluate Inherent Risk--and Improve Your Audits*, The Practical Accountant, March, 1986)

The total risk of audit (AR) is a produce of the three components (AICPA, 1983).

$$\mathbf{AR=IR*CR*DR} \quad (1)$$

Each component is a measure of the probability or is the probability of an error event.

The improvement of the communications

The audit report is probably one of the most sensitive aspects in the audit process. The indifference for the quality of the examination and the evaluation of the audit is important. If the results are not clearly transmitted to the management, the effort for the audit is meaningless.

For writing the report, the auditors use the standard features for reporting data: *clarity, concision, opportunity, completeness, a positive language and the omission of the jargon and of the acronyms*. Sometimes, these are not enough. There are three additional aspects that need to be considered:

- *The report must correspond* to the needs of the management and must be conceived to satisfy this requirement.

The auditor must:

- Anticipate the questions of the management: "where?", "when?", "how?" and "how much?"
- Provide clear answers to these questions.

The auditor also has to identify the alternative methods of corrective action.

- The answer must correspond to the level of understanding of the addressee.

The auditor must take in consideration: the environment, the education and the position in the organisation of the beneficiary and must structure the report in correlation with these aspects.

- The quality of the report.

The auditor must write a report meeting the needs of the customer and capable to become the base for the future decisions. The report must be written in the most competitive manner.

4. Conclusions and recommendations

Innovation is the effect of the changes used by the new technologies or the new procedures. It is one of the most important features of the internal audit and provides new methods for the achievement of the audit process as efficient and useful as possible.

These suggestions are:

1. Changes in the interaction with the organisation.
 - Maintaining the vertical and horizontal communications, especially with the auditors;
 - Providing a prompt feedback;
 - Developing a schedule of the personnel together with the rest of the organisation;
 - Publishing a brochure on the internal audit;
2. The internal restructuration:
 - Reducing the lack of professionalism, reorganising the personnel;
 - The development of the team work;
 - TQM aspects;
 - Defining the measuring and the certification.
3. Creating new services and methods:
 - Revising the methods for the evaluation of the risk;
 - Modifying the planning methods;
 - The specific evaluation of control;
 - Revising the process.
4. Changes in the use of the technologies:
 - The use of SSD, support systems of decision;

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- The development of the audit standardized modules.

Concluding, we may say the fundamental element of the success is *the change of culture*. Rethinking and reorganising the functions of the internal audit, the responsibility of detecting the frauds and the errors, are generally accepted as instrument provided by the management of the information of the internal audit. The internal audit becomes a part of the executive management of the organisation. It is not in the service of the management; it is instead an *element in the management process*.

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REINŽENJERING INTERNE KONTROLE U SAVREMENIM KOMPANIJAMA

Rezime: Reinženjering predstavlja radikalni redizajn poslovnih procesa, organizacione forme i svesti zaposlenih. Cilj reinženjeringa predstavljen je kvantitativnim porastom poslovnih performansi. U tom kontekstu, u radu će biti analizirani poslovi revizije kroz reinženjering. Ovaj pristup biće posmatran kroz prizmu redizajniranja i promena u svesti revizora, sa jene strane i poboljšanja rada revizora sa druge strane. Ovaj papir predlaže pristup koji je primenljiv i kod revizije marketing aktivnosti proizvodnih kompanija. Predstavlja vodič dobre prakse koja će biti izvedena na primeru Srbije i Rumunije.

Ključne reči: reinženjering, revizija, računovodstvo, poslovanje.