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# ASSESSMENT METHODS OF INTERNAL AUDIT

Methodological  
articles

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Performance indicators regarding internal audit

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## JEL Classification

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## Abstract

*Internal audit services are more and more needed within economic entities, because on one hand they are directly subordinated to the general manager, on the other hand there is an increase in credit to its recommendations, estimating that internal audit is more than just a simple compliance check based on an established referral system. Our research focuses on evaluating the impact of theory and practice in the application of internal audit process. The added value brought by internal audit function to the economic entity it is pretty difficult to establish and requires effective ways and criteria of measured. In this regard, we will try to present ways to analyze internal audit's activity by reference to some performance indicators or other specific methods. We used as research techniques: literature review, applied research and constructive research.*

### 1. Several significant aspects of internal audit

The audit is presented as a profession in which professional judgment, skepticism and ethical behavior are valued at high level. Due to globalization and a growing demand for information, audit function was and is a vital public service.

Confidence in the field of audit is increased since the beginning of its existence and will continue to be a quality service provided by professionals. A study conducted by a group of researchers in 2011, shows the level of appreciation of audit activity in enterprises as seen in Figure 1. (Beattie, 2011)

We recently conducted a study (2015) based on the same reasoning, to see the evolution or involution regarding the assessment of internal audit at the company level. The study was conducted on a sample of 60 people working in institutions / companies in which an internal audit department operates and resulted data are shown in Figure 2. (Badea, 2015)

Internal audit is an independent activity of objective assurance and advisory service designed to add value and improve the organization's activities. It helps the organization accomplish its objectives through a systematic, disciplined approach to assessing and improving the effectiveness of processes for risk management, control and governance. (IIA, online [5])

Internal audit fulfills mainly 3 major functions (As seen in Figure 3):

- Assurance: It requires an independent evaluation of the object audited and is exercised in relation to the issue of materiality and risk;
- Consultancy: It involves making recommendations leading to activity improvement, with the mentions that internal audit recommendations are not binding, but advisory;
- Sustainability: Internal auditor's attention is directed towards identifying, analyzing and assessing risk; strengthening internal control; improving management processes and the organizational relationships.

### 2. Min-max principle in internal audit

*The goals set by some will be viewed differently by others.* (Murphy's Laws)

Murphy's Law mentioned above, can be applied to internal audit. Looking at it, we can join the internal audit concept.

In microeconomics we meet the Min-max principle according to which there is to achieve maximum results with minimum effort. The same principle is found in many areas of study, such as in investment management.

This principle can be applied to internal audit, with some modifications, namely, the objectives of internal audit are to obtain maximum effect with minimum effort but not however with minimal costs.

We cannot talk in the internal audit scope about minimal effort for several reasons. Some of these reasons include:

- Any activity involves costs: Establishment of internal audit at the entity level economic costs; whether they are employees of the entity (company integrated department), whether it is outsourced, internal audit activity will result in cash outflows. In this sense, the purpose of internal audit is to reduce to zero the risks affecting the business entity, making it eligible expense for the establishment of internal audit and execution of audit engagements.

- From the perspective of qualifications and the work of the internal auditor, the profession requires multidisciplinary knowledge and continuing professional development therefore cannot be talking about an activity based on the principle: *maximum effect with minimum effort*.

By associating maximum effect with minimum costs, we aim to ensure (through the functionality of the internal audit department) that all processes/activities are running with maximum efficiency, with a high degree of efficiency, productivity, minimizing deficiencies / irregularities, so that the costs to refer strictly to inherent cash outflows (personnel expenses, costs of raw materials, supplies, taxes, suppliers, etc.) without any cash outflow due to loopholes in systems and subsystems of the company.

### 3. Evaluating internal audit

Internal Audit supports the economic entity to achieve objectives and provides management assistance to increase efficiency, control capacity and its ability to manage resources and processes. Material evidence must meet two essential qualities, namely sufficiency and adequacy. Based on the referential system, internal audit mission results are translated as findings / recommendations and internal audit report is compiled.

The added value of internal audit is highly difficult to quantify.

The added value of the audit work is not exclusive nor in the internal audit report and any recommendations and conclusions issued. These are just a means of communication with the management of the audited entity.

The value of internal audit is the ability to improve the audited system/process/activity.

One of the roles of internal auditors is to empower managers, which in turn empower other employees. However, internal auditors are bound to be relevant in the recommendations so that managers understand the recommendations and should be put into practice to avoid possible risks.

We presented briefly what we mean by adding real value through internal audit (As seen in Figure 4).

We have chosen this form of representation (relational form), because the identified elements

are interdependent, achieving one of them leads to the fulfillment of the other. This implies that by empowering mindsets we change management, change the way of thinking and how the economic entity is viewed and perceived.

However, due to this changing of mentality, the management will pay attention to risks and apply a proper risk management.

In this way risks can be identified and evaluated with greater ease. Also, errors and deficiencies can be corrected, prevented or decreased, as financial or material losses.

At the same time, we can measure the value of internal audit by assessing the financial impact on the economic entity in the future or whether the internal audit, hence the change / improve processes in a given period, brought plusses of any kind.

The added value by internal audit function requires effective ways of measuring. Touching implies internal audit performance, as in any other activity, the existence and effective and efficient combination of resources (financial, material and human). It is important that these resources be properly budgeted and allocated where needed at the time. Financial resources must be targeted on types of spending, and where internal audit is divided into several main categories: salaries of internal auditors, expenses, training expenses, office supplies necessary to conduct business in optimum conditions, expenses related to trips made under internal audit plan, etc. (Badea, 2013)

The effectiveness of the internal audit plan is evaluated by an internal quality control audits and assessments can be internal or external. (As seen in Figure 5).

There are several indicators used to measure / assess the value addition provided the company but does not fully reflect the actual value of the internal audit function. Effectiveness of internal audit is measured using instruments such as indicators, surveys or benchmarking. (IIA, 2010)

Indicators restore the image and quality assessment of internal audit activity and the means of improving efficiency.

Indicators are those that give the image quality of activity and are, in essence, a means of improving efficiency and are calculated in three categories: activity indicators, quality indicators and cost indicators (as sketched in Table 1).

Benchmarking is the use of criteria both qualitative and quantitative to understand where you can be among members of the same profession, which is aimed at measuring the identification of best practices to achieve greater efficiency, a kind of smoothing methods, procedures and work rules that give greater efficiency.

The survey is another important means of measuring the effectiveness of the internal audit, only that he must be regarded as very sensitive if it

is not developed by specialists may indicate irrelevant or even contradictory answers that will influence the judgment of beneficiaries.(Badea, 2013)

Such a survey was developed by one of the Big Four company, KPMG through its Audit Committee Institute. The survey has a body of four parts (sections), as follows: (KPMG, 2009)

- Section A: completed by the audit committee; targets understanding the mission, skills and experience of the auditors, communication between members of the audit team, mission performance;
- Section B: to be completed by the heads of the business and the chief financial officer; targets: planning, work program, overall performance;
- Section C: completed by the external auditor;
- Section D: self-assessment- to be completed by the head of internal audit.

#### 4. Conclusions

Modern management of economic entities, regardless of the nature of society, whether it is public or private entity status cannot be conceived without a rigorous and flexible control. Running a company requires a permanent and systematic control of activities.

Patrimonial entities whose activity is carried out in a dynamic business environment and aggressive, be flexible, be able to adapt easily and quickly to these changes in order to survive, their activity as an effective, ie ensuring the principle of continuity activity.

As mentioned, we find it difficult to assess how the internal audit helps to increase efficiency and company's performance, as there is no mathematical model, a static or dynamic model to measure these values. This can be seen, in our view, only by assessing activities / processes audited after implementing the recommendations made by the internal audit department. Thus, by adding these improvements at company level, we can also determine whether the internal audit adds any kind of value.

Also, as there is no general model applicable to the assessment of internal audit, we consider appropriate that each economic entity that has in its structure a department of internal audit, to devise a customized assessment model by calling the indicators listed in Table 1 or by elaborating a specific survey or use even complex models such as the Balanced Scorecard, Bone Fish Bone, etc.

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Table No.1  
*Indicators used to measure / assess internal audit*

<b>Type of the indicator</b>	<b>Indicator</b>	<b>Formula</b>
<b>Activity</b>	<i>Measurement of plan and achievement and outcomes improvements</i>	• <i>number of missions developed/ number of missions set in the plan</i>
	<i>Measurement of the average audit time</i>	• <i>number of audit days / number of missions</i>
	<i>Measuring the time evolution for strict auditing operations compared to the overall time</i>	• <i>number of audit days / days worked</i>
	<i>Measuring the evolution of training allocated to each party auditor</i>	• <i>number of training days / days worked</i>
<b>Quality</b>	<i>Measurement of the evolution of the average number of pages of audit reports</i>	• <i>number of pages of reports / number of reports</i>
	<i>Number of missions</i>	• <i>number of unforeseen tasks / number of missions</i>
	<i>Assessment recommendations</i>	• <i>recommendations rejected / total recommendations</i>
	<i>Measuring the quality of implementation of recommendations</i>	• <i>unrealized recommendations / accepted recommendations</i>
	<i>Measurement of working periods for Heads of Mission and senior auditors</i>	• <i>number of days devoted to management / days worked</i>
	<i>Assessing the quality of work</i>	• <i>incomplete audit files / number of missions</i>
<b>Mission Costs</b>	<i>Evolution of budget and staff employees</i>	• <i>cost of service / number of auditors</i>
	<i>Comparison of the workday market costs</i>	• <i>cost of service / number of days of mission</i>

Source. Author's personal representation.

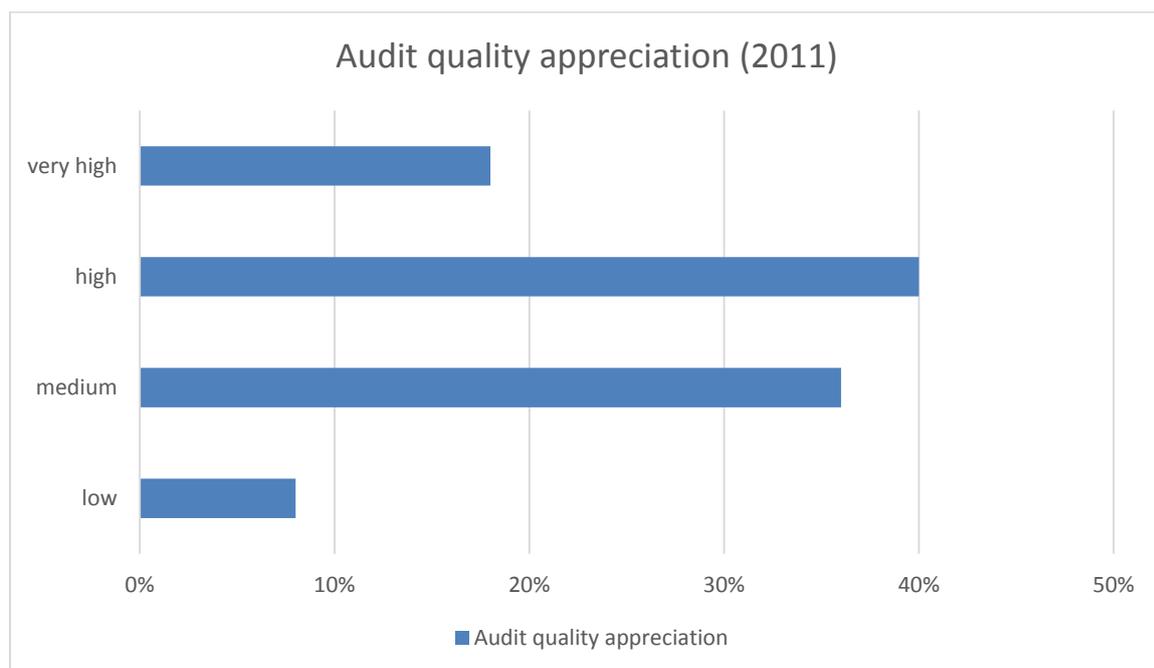


Figure No.1 Audit quality appreciation.

Source: *Factors that affect the quality of an audit*, UK 2007 Regulatory Environment, April, 2011

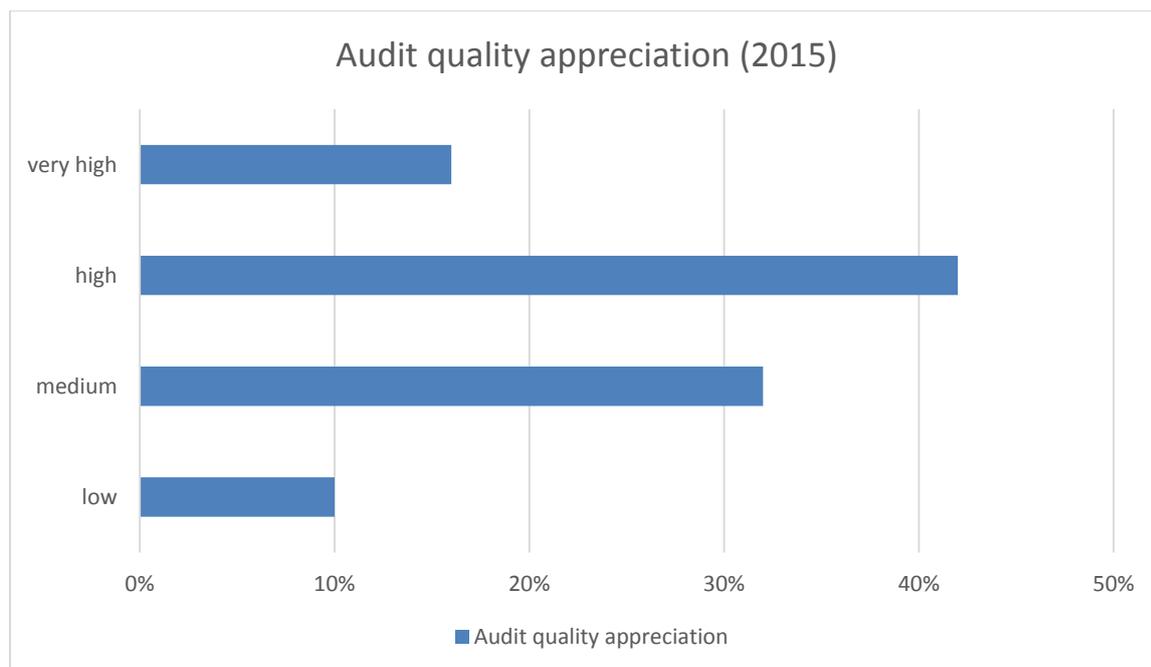


Figure No.2 Audit quality appreciation.  
Source: Author's study in Constanta, Romania, June, 2015

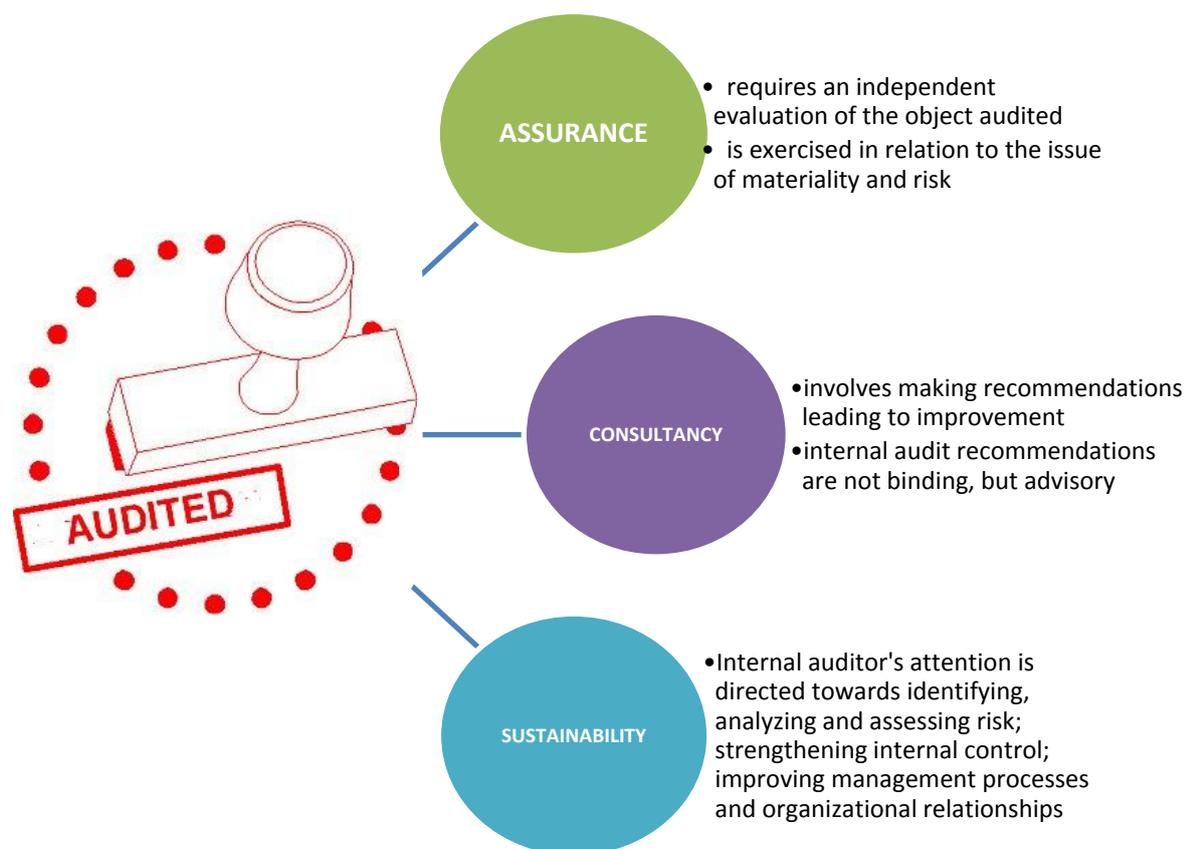


Figure No.3 Internal audit functions.  
Source: Author's personal representation

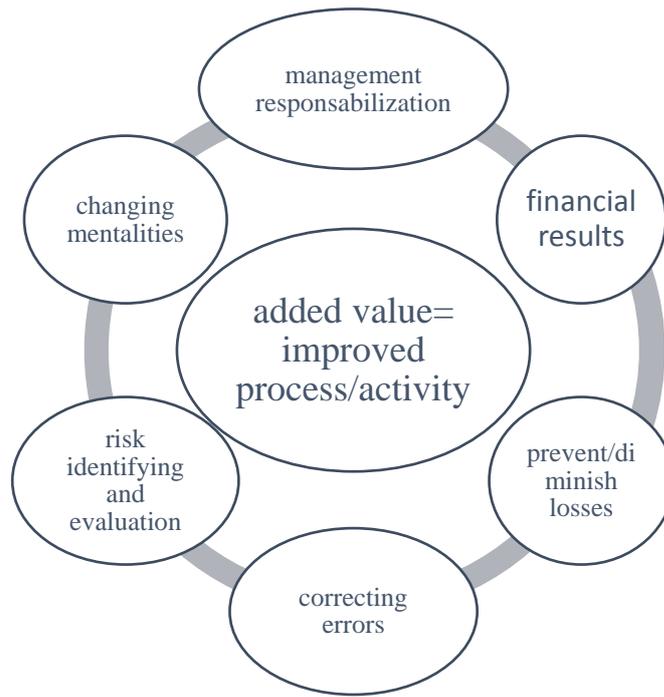


Figure No.4 Added value.  
Source: Author's personal representation

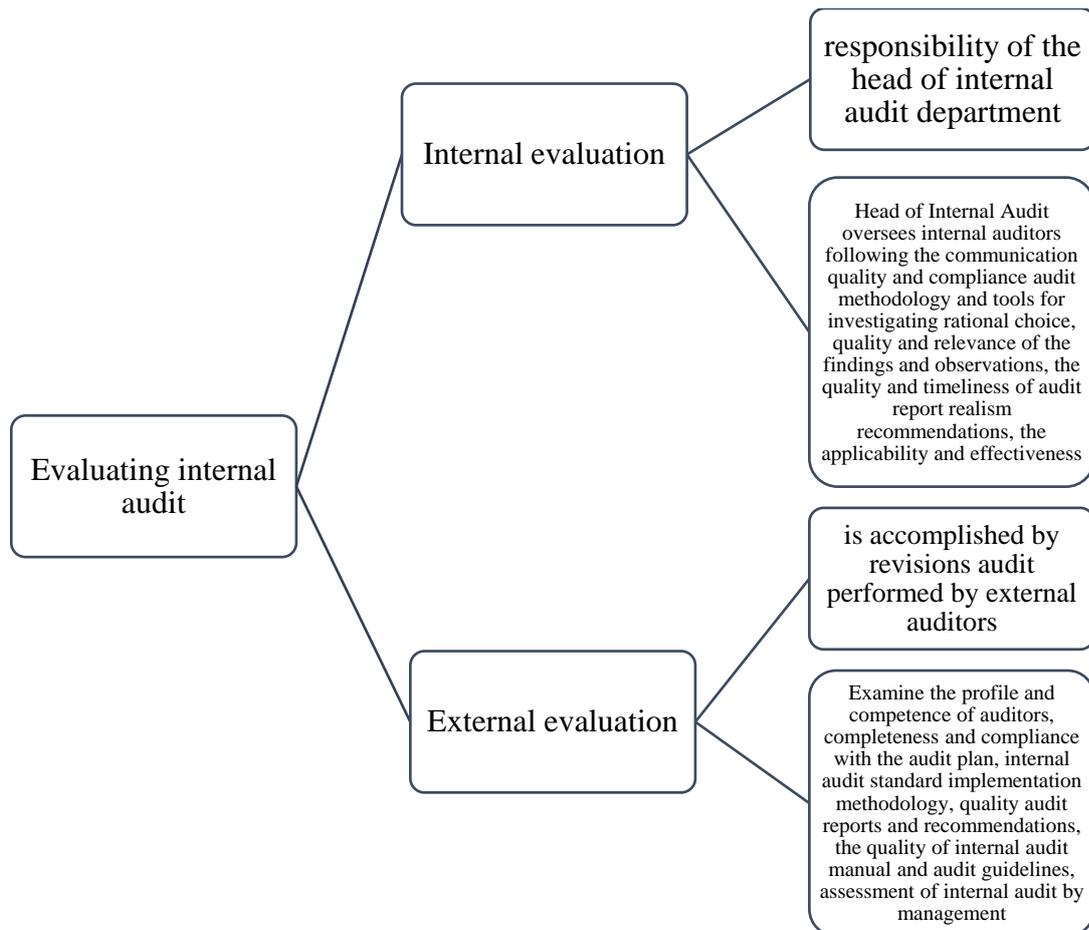


Figure No.5 Methods of evaluating internal audit.  
Source: Author's personal representation (Badea, 2013)