

Factsheet: Operational Auditing

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What is the IIA?

The Institute of Internal Auditors (IIA) is the global professional body for internal auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world including Australia.

As the chief advocate of the internal audit profession, the IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for internal audit integrity and professionalism around the world with its 'International Professional Practices Framework' (IPPF), a collection of guidance specifically designed for internal auditors.

The IIA was established in 1941 and now has more than 200,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education and security.

The IIA first issued international internal audit standards in 1978.

What is Operational Auditing?

Almost every internal audit can also be an operational audit. Operational audits are distinguished from other types of internal audit by having an objective to review efficiency, effectiveness, economy and ethics (known as the 4Es). They may also have other objectives such as assessing compliance with regulation or testing controls of an information system, but the direct examination of one or more of the 4Es is what is important.

Another term commonly used is performance auditing which has fundamentally the same objective:

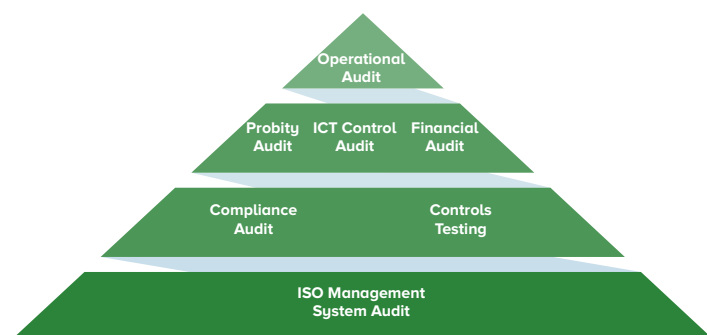
| Operational Auditing | Performance Audit |
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| <i>An audit of the use of resources to assess whether those resources are being used in the most efficient and effective ways to fulfill an organisation's objectives.</i> | <i>An audit of the management of an organisation, program or function to identify whether it is being carried out in an efficient and effective manner and whether management practices promote improvement.</i> |

The term 'operational audit' is most commonly used in the corporate sector whereas the term 'performance audit' is often used in the public sector. Corporate sector operational audits are conducted within the organisation, while public sector performance audits may be performed by internal audit or by the external auditor (Auditor-General).

While there may be purists who will argue there is a difference, the reality is they both seek to achieve the same objective. For the purpose of this Factsheet, operational auditing and performance auditing have been treated interchangeably and are just called 'operational auditing'.

How Does Operational Auditing Differ from Other Types of Auditing?

As stated above, the critical difference is in the audit objective and therefore in the skills and other resources that must be applied to the engagement. There is an auditing continuum that can be simplistically expressed in a hierarchy:



As we move from basic auditing to more complex forms of auditing, the complexity of the engagement and the difficulty in getting agreement to the engagement objectives from the audit sponsor increases. It can also be more difficult to find appropriate assessment criteria and the necessary skills to make those assessments.

It also means the engagement is moving from a focus on outputs to addressing outcomes and benefits.

Economy, Efficiency, Effectiveness and Ethics

The aim of using an operational auditing approach is to find out:

- › Whether business operations are being managed in an economic, efficient, effective and ethical manner (the 4Es).
- › Whether procedures for promoting and monitoring the 4Es are adequate.
- › Whether real improvements can be made – not just assessing whether there is compliance or non-conformance.

Economy is concerned with minimising the cost of resources used (people, materials, equipment, etc), having regard to the appropriate quality required – keeping the cost of inputs low without compromising quality.

An example could be where healthcare supplies or services of a specific quality are purchased at the best possible price.

Efficiency is concerned with the relationship between goods and services produced (outputs) and the resources used to produce them (inputs) – getting the most from available resources. Efficiency is about 'doing things right'.

An example could be where the quality of healthcare has been improved over time without an increase in cost.

Effectiveness is concerned with achieving predetermined objectives (specifically planned achievements) and having the actual impact (output achieved) compared with the intended impact (objective) – achieving the predetermined objective. Effectiveness is about 'doing the right things'.

An example could be where disease rates have fallen as a result of healthcare provided.

Ethics is the standard of moral behaviour and conduct expected of organisations and their employees. This has a direct effect on the operation of controls and therefore on achievement of the other 3Es.

Performing an Operational Audit

The sequence of an operational audit is likely to match the sequence of other internal audits:

- › Establish what should be done / achieved.
- › Establish what is being done / achieved.
- › Compare 'what should' with 'what is'.
- › Investigate significant differences.
- › Assess effects of the differences.

Most audits stop here. To be truly valuable, the audit should go further:

- › Determine the cause of the differences.
- › Develop audit findings and value-adding options and improvement actions.

These are the difficult parts. It is usually easy to work out an effect but trying to isolate the cause can be much harder.

Hence, many internal auditors find it easier just to report on what is wrong and avoid trying to identify the root cause of a problem.

Often an internal audit recommendation will be something like 'It should be reinforced that employees follow the procedure'. This is lazy internal audit work and not a particularly enlightened recommendation. There may be many reasons why an employee is not following procedures. But not many employees will deliberately disobey a procedure unless it is a bad procedure, or something else is preventing them from complying with it.

Working with Management

The real value in an internal audit is determining the cause of the differences between 'what is' and 'what should be' and identifying value-adding options and improvement actions. This is the essence of operational auditing.

The management and staff of an area know a lot more about the audit topic than the internal auditor. By working closely with management and stakeholders at the conclusion of the audit to identify root causes and discuss improvement options, a much better outcome can be achieved.

A facilitated workshop at the end of an audit that involves the internal audit team and a key group from business areas can be very productive to work out root causes and decide the most appropriate improvement actions from the audit.

Conclusion

- › It is possible to include a value-adding element in any internal audit.
- › Operational auditing will provide added value to your organisation.
- › Including an operational auditing element in your audits can enhance the image of internal auditing with the people being audited and with management.
- › You can increase your job satisfaction by adding operational auditing to your activities.

Acknowledgement

The content of this Factsheet has been informed by:

- › An article authored by Andrew Cox in the book 'Qfinance' published by Bloomsbury.
- › Michael Parkinson in Adelaide, Australia.

Helpful References

Factsheet 'Internal Audit Benefits', Institute of Internal Auditors - Australia

Factsheet 'Root Cause Analysis', Institute of Internal Auditors - Australia