Auditing efficiency and effectiveness

A systemic audit approach from six different perspectives

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Internal audit mission

- Quality assurance of the internal control system
  - Operational auditing!
  - Compliance auditing!
  - Financial auditing!
  - Efficiency and effectiveness auditing?
    - That the organization performs its mission as intended, with optimized use of resources
    - In order not to participate in strategic decisions, we recommend management to “consider”...
Efficiency and effectiveness audit

- At three levels:
  - Owner/members/parliament level
    - Not an internal audit responsibility...?
  - Board/government level
    - Effective conversion of board/government decisions/regulations into instructions, policies, objectives etc.
  - Company/organization/agency level
    - Choice between alternative actions to meet objectives efficiently and effectively
    - Effective evaluation and follow-up
    - Demings PDCA Circle (Plan, Do, Check, Act)
Efficient and effective

- Efficient
  - Achieving maximum productivity with minimum wasted effort or expense

- Effective
  - Successful in producing a desired or intended result, fulfilling a specified function in fact
The Call Center Case

- Large IT-support center
- 4 equal departments
- Efficient when a solution is found within 3 minutes, on average
- Effective when solving 90% of customers problems
- 4 department managers
- Monthly reporting KPI to one Head of Support Center
Relatively efficient or effective

- Nothing is per definition efficient or effective
- We must first define what to measure against
  - Michelin restaurants
  - McDonalds
  - Rolls-Royce
  - Tata
  - Designer objects
  - Mass production
- Similar to quality!
Type and criteria

- Effective in what sense?
  - Customer satisfaction? (Commercial companies...)
  - Benefits to society? (NGOs...)
  - Intended political effect? (Government agencies...)
  - Secure digital information? (IT-departments...)

- Efficient at what level?
  - Quality to satisfy 90% of customers needs?
  - Activities to keep pollution below 2%?
  - Keeping unemployment below 8%?
  - No IT-security breaches?

- “Doing the right things, and doing things right!”
The evaluation model

- “Inspired by” John Seddon’s research
  - British occupational psychologist researcher, professor, management thinker and author
  - Visiting Professor at Buckingham University Business School
  - Specializing in the service industry
  - Critical of target-based management, and of basing decisions on economies of scale, rather than "economies of flow”
  - Systems thinking
  - (Wikipedia)
Auditing in six different dimensions

- Analysis of the purpose of the system
  - From the perspective of owners, politicians and citizens
- Analysis of demand
  - Real and unnecessary
- Analysis of capability
  - How competently the organization responds to demand
- Analysis of the efficiency of processes
  - How efficiently the business can manage workflows
- Analysis of system factors
  - Structure, organization, competence, tools, rules, procedures, goals or performance measurement systems
- Analysis of management and management philosophy
  - Degree of hierarchy, customer focus and control focus
The purpose of the system 1

- Formally
  - Bylaws (company)
  - Mission (NGO)
  - Regulations (government agency)
  - Rules of procedure (support process, IT, HR etc.)
  - Etc.

- Informally
  - Organizational image (trade mark, reputation etc.)
  - Stakeholder relations (owners, customers, citizens)
  - Social responsibility commitment (environmental)
  - Etc.
The purpose of the system 2

- Audit procedures
  - Obtain documentation supporting the mission of the organization
  - Discuss with top management whether the activities of the organization agree with the mission and with the commitments to stakeholders
  - Identify any shortcomings between the formal mission/commitments and the activities
  - Identify any activities which do not support the mission/commitments
  - Discuss product output, service delivery, stakeholder satisfaction
The purpose of the system 3

- The Government Agency Case:
  - Instructions from the Government
  - Political targets
  - Budget restrictions
  - Citizens and organizations are stakeholders
  - Strong social responsibility commitments
    - Long distance between the politicians and the agency professionals
    - Misunderstood instructions due to political language
    - Risk for more focus on production than objectives
    - Risk for more focus on resource (budget) management than on results
Analysis of demand 1

- Real and unnecessary
  - Everything that the stakeholder does in its meeting with the organization
  - Real demand – what the organization wants in order to produce efficiently and effectively
  - Unnecessary demand – what causes unproductive activities
  - The precision of the relationship is important
Analysis of demand 2

- Audit procedures
  - Identify the reasons why stakeholders meet the organization
  - Identify the contact points, physical, digital, silent expectations etc.
  - Identify the contact filters, where and why the organization limits the stakeholders demand, information etc.
  - Investigate any areas of unnecessary demand as incomplete orders, misconceptions etc.
  - Investigate any activities caused by unnecessary demand as reminders, over delivery etc.
Analysis of demand 3

- The Consulting Company Case:
  - Close cooperation with the customers
  - Orders vary in complexity and have a long life
  - Misconceptions must be avoided
  - Relationships must be safeguarded
  - Customer manager is a key contact
    - Any misunderstanding may cause significant efficiency, effectiveness or legal consequences
    - Need for high customer competence and involvement
    - A well designed customer interface may increase efficiency and effectiveness in the delivery
Analysis of capability 1

- How the organization responds to normal demand
  - Capacity for normal circumstances
  - Competence for normal demand
  - Capability for exceptional situations
  - Content of services
  - Quality of service
  - Effectiveness focus!
Analysis of capability 2

- Audit procedures
  - Obtain process descriptions for normal procedures
  - Discuss what constitutes normal demand and how the origination is designed to deliver under normal circumstances
  - Discuss how excess demand is/will be dealt with
  - Identify how the flow and load are measured and analyzed
  - Discuss how sufficient delivery and quality is maintained under a normal variance of demand
Analysis of capability 3

- The Public Accounting Case:
  - Significant seasonal fluctuations
  - Need for emergency capacity
  - However, general overcapacity is a waste
  - Each service requires a specific competence level
    - Recruiting for busy-season
    - Education and training during slow-season
    - Planning and scheduling systems
    - Quality assurance procedures
The efficiency of processes 1

- Where is value created with the right value at the right time
  - Workflows to optimize the processing time
  - Eliminate activities which do not create value
  - Eliminate bottlenecks in the processes
  - Eliminate resorting, recasting and duplication
  - Resolve cases at first contact
  - Efficiency focus!
The efficiency of processes 2

- Audit procedures
  - Obtain flowcharts over the production and the support system to be analyzed
  - Identify where the key competences are located
  - Identify where activities are performed solely for internal purposes and do not add value
  - Discuss whether key competences can be located earlier
  - Analyze if the workflow can become more efficient if automated, or if this has lead to duplication of work
The efficiency of processes 3

- The McDonalds Case:
  - Customers focus on "Time-to-meal"
  - All non-productive processes and bottlenecks are eliminated
  - All remaining processes are designed to optimize the workflow
    - Need for an intermediate storage
    - Need for predefined procedures
    - Need for a precision in the customer interface
Analysis of system factors 1

☐ How the actual work is performed and organized

- Organizational structure
- Organization of work processes
- Rules and procedures
- Competences and skills
- Tools
- Targets and follow-up systems
- Hard KPI:s and soft indicators
- Mandated procedures or learning organization
- “What gets measured, gets done!”
Audit procedures

- Obtain process descriptions of the production subject to audit
- Determine if the processes are designed according to function or process
- Investigate if competences are sufficient for the tasks
- Investigate if the tools are sufficient for the tasks
- Investigate into the system for performance measurement and follow-up
- Determine if permanent indicators (for planning of management) relevant for the objectives
- Investigate if volume- and capacity indicators are used for planning
- Investigate if temporary indicators are used to estimate the type and extent of problems which need attention
Several Possible Cases:

- Functional, process or matrix
- Piecework, line work or project
- Management by description or objective
- Work allocated by competence, experience or availability
- Manual, digital or automated
- Long term targets or immediate review
- Monitoring by numbers or indicators
- Space to design solutions
Management philosophy 1

- Degree of hierarchy, direction of control, production or customer focus, financial or process (system) control
  - Formally controlled or management by objective
  - Top-down control or employee trust culture
  - Level of stakeholder influence on products/services
  - Control based on budget or on objectives
  - Mandated procedures or learning organization
Management philosophy 2

- Audit procedures
  - Obtain an organization chart, rules or procedure and delegation order
  - Discuss the organization with management to determine whether the management system supports:
    - The mission of the organization
    - The legal requirements
    - The complexity of tasks performed
    - The relationships with stakeholders
    - Etc.
Management philosophy 3

IT-development Case

- Business driven IT-development
- Business sends ideas to IT
- Agile or Waterfall
- Deploy oriented (after security test...)
- Business evaluates solutions on-line
  - Bottom-up approach
  - Still too much hierarchy
  - Customer focus (IT is production)
  - Process (system) control
Summary

- **Purpose**
  - If the organization has not understood its purpose, we can stop right here!

- **Demand**
  - Do we understand exactly what the stakeholders want?

- **Capability**
  - Do we execute correctly according to the demand?

- **Processes**
  - Is the flow optimized?

- **System**
  - Is the organization designed to meet its tasks?

- **Management**
  - Does the governance culture support the mission?
Conclusions

- A fourth audit area for internal audit
- Systemic approach
- Six loosely related perspectives
- First perspective (purpose) is the most important
- No financial perspective
- No internal control perspective
- A focus on opportunities rather than risk
- Not limited to certain organizations
- Recommend management to “consider”...
- Unnecessary demand
- Nothing is per definition efficient or effective
Your questions?
My Questions:

- Does this model relate to 3LoD, to COSO or Lean?
- How do we translate or explain the concepts?
- Is this really Internal Audits business?
- Can strategies be assessed with this model?
- How have the audits been received?