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INFLUENCE OF INTERNAL AUDITING AND PROBLEMS OF ITS ESTIMATION AND PROGNOSIS

1. Introduction

The influence of internal auditing is actually experienced by all members of the process of auditing. Individually they are the auditor, the audited and the recipient of the audit report. The paper analyzes the influence of internal auditing on the audited and to present problems of its prognosis and estimation. M. Richter states that internal auditing may be treated as investment and analyzed accordingly. Every head of an enterprise should rationally evaluate benefit (the positive influence) and disadvantages (the negative influence) of these investments. As an investment the internal auditing is reasonable only in the case when advantages exceed disadvantages. Author of the article analyses positive and negative influence of internal auditing.

The work is based on the practical experience, the analysis of standard documents, regulating the internal audit organization, and various related literature sources. Monographic, analysis and synthesis methods are used in this work.

2. Influence of internal auditing

Analysis of scientific literature has established the internal auditing to have the strongest influence on the audited. Prognosis of the influence enables to quantitatively estimate advantages and disadvantages of internal auditing. This is a versatile influence – both positive and negative. Some authors emphasise only positive impact of audit. Others notice that audit may also have a negative influence. A. Zünd indi-

cates that every inspection has informative impact and influences behavior. R. Göbel divides the influence of internal audit into correcting, educational, prevention and guarantee impact. M. Richter distinguishes analogical groups of positive impact and at the same time draws attention to negative impact of auditing: audit expenses, refusing reaction and erroneous attitude. Many authors focus on separate groups of impact without interrelating them.

2.1. The positive influence of internal auditing

Having analyzed various literature sources the author makes the following suggestions: to detail the positive influence of internal audit and to present it (Fig.1).

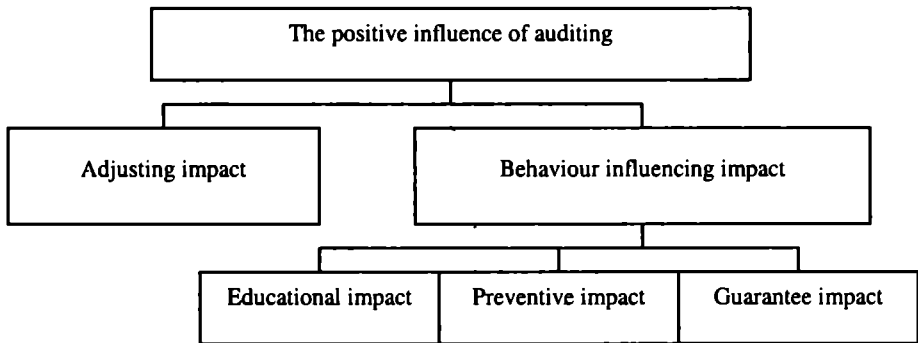


Fig. 1. Positive influence of internal auditing

The figure shows the positive influence of internal auditing, divided into two big groups: adjusting impact and behavior influencing impact. Further the separate groups of positive impact are analyzed.

Adjusting impact. In order to correct mistakes and divergences first of all they have to be determined. The adjusting impact of internal auditing is shown by elimination of the determined erroneous conditions. As internal auditing has no right of direct interference into the audited system or process, it is problematic to speak about direct adjusting impact. As a rule the auditor has no right to require for the correction of the mistakes. The author of the paper thinks that such behavior of the auditor could be evaluated as passive one. In this case the positive influence is expressed by the recommendations given by the auditor on the means of adjusting to be applied and how the known mistakes and disadvantages could be eliminated. Statements of the auditor should be based on obvious evidence that is substantiated by documents. Citation of the violated direction or order is not sufficient; the factual or possible influence of such divergence on the activity of the enterprise should be clearly explained. Following the decision of the head of internal auditing service additional interim report may be prepared where the head of the enterprise

is informed about the revealed faults and necessary decisions to be urgently made. Besides, it is recommended to supply the draft audit report with the note about conformity of former audit reports and to indicate the contradictions that have not been eliminated. Before making final internal auditing report the recommendations of internal auditors should be discussed with the head of the audited enterprise or head of its structural subdivision. The normative literature indicates that small everyday mistakes that can be or have been corrected on the spot should not be mentioned in the report. However, the auditing report should indicate the inadequacies, which, although having been corrected, are rather important and should receive attention of the governing body. Author of this article thinks that it would be useful to discuss the mistakes and inadequacies as well as recommendations for corrections not only with direction but also with workers of lower rank. Such coordination of audit recommendations strengthens the probability of complete and without delay implementation of these recommendations by competitive individuals. Information about the mistakes that have been established during audit may have a positive impact in this respect as it becomes the starting point for the governing body of the enterprise and for the audited to make corrections in recurring and new activity [Peemöler 1998; Richter 2000].

Educational impact. M. Richter states that this impact is closely related with the adjusting impact. This may be correct supposing that only accidental mistakes are revealed during audit. In such a case it possible to state that auditors provide the audited with the knowledge about the norms and methods to be applied and so help them to improve. Generally, the educational impact is shown when an individual changes his/her behavior due to the experience [Göbel 1996]. Author of the article expresses the opinion that similar effect may be achieved by means of teaching and by the efforts of the audited to improve.

The education impact resulting from the internal auditing may be reduced in the course of time by effect of suppression. This may be manifested among individuals especially in the case of weak interest in learning or insufficient preparation for work. On the level of collective this effect manifests itself when the personnel is changed and abilities of the group are "forgotten". In general, it may be supposed that educational impact has the tendency to pine with the increasing time span from the audit. The conclusion can be drawn that educational impact of internal auditing on future conditions of internal control system is insignificant. However, in the case of absence of the educational impact the audited may start repeating the same mistakes just after the audit is finished. Therefore, not long term impact of education but, on the contrary, in the course of time languishing educational effect should be discussed.

Preventive impact. Of all the behavior influencing impacts this one is in the most detail analyzed in scientific literature. Some authors consider this impact to be the most important effect of internal auditing [Churchil 1997]. In literature

this impact also has the name of prophylactic, precautive, protective or stopping impact. In the course of audit, on the one hand, the mistakes are revealed, on the other hand, the impact of mistakes prevention is made. In this way not only mistakes are determined but also potential divergences from norms are stopped. Prophylactic impact is manifested when the enterprise knows that the fields that are considered to be less important may become the objects of audit selection. To achieve that H. Kellerer suggests to do selection according to the principle of coincidence. Author of this article considers this principle of selection to be not quite appropriate as the objects of low volume of mistakes may be selected. In such case the audit expenses exceed the obtained benefit and the principle of economizing is violated. Auditing is not limited only to the purpose to reveal mistakes. They have to prevent the occurrence of mistakes. The prophylactic impact is caused by the knowledge about the existence of internal auditing in the enterprise and the possibility of inspection in certain field of its activity (Peemöler, 1998). This knowing and, especially, waiting for sanctions after audit conditions more strict following of the set norms than in the case of absence of inspections. Prophylactic impact, first of all, reduces intentional mistakes. It stops unintentional mistakes, which are made due to carelessness and may be avoided if the audited make efforts. Prophylactic impact predetermines more careful fulfillment of tasks from the very beginning and prevents deliberate counterfeits.

Guarantee impact. This impact manifests in two levels: the level of the audited and the level of the audit report recipients. Positive result of inspection established in the level of the audited allows to state that the requirements are met. R. Göbel says that negative result of inspection can have guarantee impact if by means of constructive critics the audited are given instructions how to follow the requirements. In this case the results of this impact are revealed in future.

In the level of the audit report recipients the inspection increases confidence in the course and results of work. Positive result of inspection means that the audited processes meet the provided recommendations: If divergences are established the inspection provides the necessary information how to eliminate them. Richter states that audit decreases doubts about reliability of the activity results. In the case of effective inspection and presence of information about the established mistakes it is possible to state that important mistakes are absent. Author of this paper questions this statement. Audit only reduces probability that important mistakes are absent, i.e. the probability of mistakes after audit is weaker than that in the case of no audit done. From this standpoint internal auditing increases reliability of the inspected results of activity. At the same time audit gives stronger confidence in heads of the audited subdivisions.

2.2. The negative influence of internal auditing

Having analyzed various literature sources the author of this paper makes the following suggestions: to divide the negative influence of internal auditing into two big groups: behavior influencing impact and expenses related impact. Overlap of separate groups of negative influence of internal auditing has been noticed. In figure this impact is described in more detail (Fig. 2).

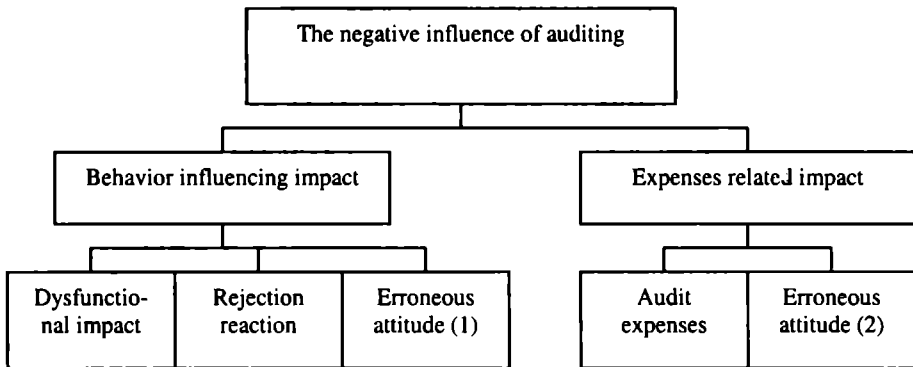


Fig. 2. Negative influence of internal auditing

The figure shows the negative influence of internal auditing, divided into two big groups behavior influencing impact and expenses related impact. Further the separate groups of negative influence of auditing are analyzed. Attention should be paid to erroneous attitude, which may not only influence the behavior of the audited but is also related to expenses and, thus, attached to the second group of negative influence but in different aspect.

Dysfunctional impact. It is not always the case that auditing makes positive influence. R. Göbel and J. Baetage indicate that activity of internal audit is not always preventive. In certain conditions a negative impact may occur in the course of inspection. Then the results of the audited activity may become worse. H.R. Thieme states that very strict and intensive inspection may set the audited inimically and, thus, cause a dysfunctional impact (i.e. when certain means of influence result in the effect that is opposite to the expected one). In such case internal auditing is interpreted as a signal of distrust and as unpleasant, boring and, even, faultfinding interference. Dysfunctional impact may manifest by redirection of the responsibility to the head or the auditor, by open opposition to the means of inspection, by manipulating important audit information and by other similar effects. J. Baetage expresses the opinion that it may cause the increase of mistakes in frequency.

The following group of negative impact is closely related with dysfunctional impact.

Rejection reaction of the audited. Frequent inspections cause in the audited the reaction of rejection and even opposition. It is due to discerning the distrust in the audited. Very often people in principle are oppositely disposed to the inspection of their activity as inspections are considered to contradict the aspirations to recognition and confidence. The audited most likely is oppositely disposed when he/she has no or very poor understanding about auditing and its aim. The same reaction of the audited arises when a danger is felt that the inspection may result in change of the usual working environment or social status. Besides, sometimes internal auditing is treated as additional burden, which disturb work. The same arguments can be presented when the audited avoid collaboration with the auditors. A conclusion can be made that due to the rejection reaction of the inspected quality of the audit i.e. its efficiency, as well as results of the audited enterprise activity suffer.

Audit expenses (use of resources). Personnel expenses have the highest specific weight in audit expenses. Usually this means expenditure of auditors' time and other direct costs of inspection. On the basis of practical experience the author of this article indicates the existence of indirect costs of audit, for example, expenditure of the audited time. They occur when data and documents are prepared for inspection.

Erroneous attitude. Auditors as well as the audited may be wrong. This means that results of audit are not always correct. Two types of errors may be distinguished here.

1) The mistakes that are indicated by the auditor in the report, although, in reality they do not exist. Often the reason of these mistakes in the lack of information at the auditor's disposition. These mistakes can be avoided by applying filters. For example, other member of the audit crew checks the report. Particularly often practically applied filter is presenting the draft report to the audited. As a rule, the latter are the most interested to reveal such mistakes.

2) The auditor does not reveal any mistakes, although, some inadequacies to norms do exist in the analyzed documents. Mistakes of the second type are more dangerous than those of the first type as the audited are not interested to show their mistakes to the auditors. Reasons of this type of mistakes may be as follows: insufficient qualification of the auditor, application of improper methods of inspection, low intensity of audit, lack of independence.

To summarize these two types of mistakes it is possible to state that they both have negative impact. The first one because the audited feel to be incorrectly accused and it causes their hostility. Negative impact of the second type of mistakes is that addressees of incorrect audit report may make erroneous decisions if they trust the obtained information.

3. Problems of prognosis, estimation and attributing or internal auditing impact

Positive and negative impact can be analytically identified and described but it is impossible to prognoses them.

Quantitative evaluation of positive and negative impact of internal auditing meets enormous difficulties. The only existing exception, like in prognosticating, is direct expenses of audit that can be easily evaluated.

Many authors present similar recommendations on positive evaluation of internal auditing. For example, in order to establish adjusting impact of internal auditing the following prognoses of monetary evaluation of this impact are suggested [Bloth 1997; Cichon 1998; Richter 2000]:

1. about type and amount of mistakes existing in the inspected object;
2. about type and amount of those mistakes that will be revealed by the auditor and indicated in the report;
3. about the meant taken by the audited subdivision and their impact.

The knowledge of audit science that is necessary for such prognoses do not exist yet. Therefore, the skepticism that this situation will not change in near future is natural [Richter 2000].

K. M. Bloth and W. Cichon indicates that the following things should be taken into consideration when prognosing adjusting impact of internal auditing:

1. Implementation of improvement recommendations is the responsibility of the governing body of the enterprise but not internal auditing. Adjusting impact of the audit very much depends on the positive attitude of the governing body of the enterprise to the improvement recommendations.
2. Limiting of internal auditing activity when other services or other department of the organization at the same time perform actions of the same trend usually make the situation more difficult.
3. Amount of mistakes in the inspected field, their type and distribution in time will not be known in future.
4. Monetary evaluation of mistakes is highly problematic.

H. Königsmaier suggests theoretically express the adjusting impact of internal auditing as costs of faults that occur due to bad situation of internal control system that has not been revealed due to insufficient inspection. Practical calculation of educational impact is very complicated. Quantitative evaluation of this impact has been successful only for production process.

Evaluation of preventive impact requires to determine the mistakes and economical consequences that may result in the case of absence of internal audit. This should be done before the internal auditing is started. However, preventive impact is hardly appreciable and has latent influence on the behavior of the audited. The same is true about dysfunctional impact, which practically is not ap-

preciable. Besides, according to modern understanding of internal auditing. The inspections should be understood as consulting activity but not strict supervision. The occurrence of dysfunctional impact related to inspections is possible; however, in the case of sufficiently competent audit personnel this undesirable effect can be avoided.

Comparison of all the groups of behavior influencing impact shows that guarantee impact is the least concrete. Its description allows to note that guarantee impact gives positive effect for further control behavior. But it is not evaluated quantitatively.

Next to the above mentioned problems of prognosis and evaluation of audit impact a specifically problem of internal auditing impact attachment exists. It is not clear where the results that occurred as the consequence of the inspection means application should be attributed to: to the auditor or to the people who listen to the auditor's recommendations and implement them. In this case an one meaning attribution is impossible.

If the audited enterprise considers internal auditing as investment it continuously evaluate advantages and disadvantages of audit. The opinion exists that the benefit of audit is depreciated because of difficulties in evaluation and prognosis of positive impact. This hypothesis is based on the experience that in the situations when head of the enterprise has to make a decision quantitatively evaluable factors are of greater importance than qualitative factors. If the enterprise does not consider audit as investment, the decision is influenced by the image of the auditor and general attitude of the governing body of the enterprise to internal auditing.

4. Conclusions

1. The following has been established having analyzed opinions of different authors about the impact of internal auditing:

- a) internal auditing can have both positive and negative impact on the audited;
- b) in certain conditions the impact of internal audit may change from positive to negative one;
- c) quality of audit suffers because of negative impact on the audited.

2. Having analyzed various literature sources the author of this paper makes the following suggestions:

- a) to divide the positive influence of audit into two big groups: correcting and behavior influencing impact; the latter group may be detalized into the following groups: educational impact, prevention impact and guarantee impact;
- b) to divide the negative influence of audit into two big groups: behaviour influencing impact and expenses related impact; the impact of negative influence on behavior may be divided into: dysfunctional impact, refusing reaction and

erroneous attitude of the audited (1); expenses related impact may be divided into: audit expenses and erroneous attitude (2).

3. The research has revealed problems of prognosis, estimation and attributing of internal auditing impact. The author of this paper has established the following:

a) auditors almost always rely only on personal experience, therefore their prognoses are not always exact and reliable;

b) exact prognosis of positive and negative influence of internal auditing, except direct audit expenses, is impossible;

c) quantitative estimation of positive and negative influence of internal auditing faces great difficulties; only audit expenses can be qualitatively estimate.

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WPLYW AUDYTU WEWNĘTRZNEGO, PROBLEMY JEGO OCENY I PROGNOZY

Streszczenie

Wpływ audytu wewnętrznego zasadniczo czują wszyscy uczestnicy audytu. Audyt wewnętrzny można traktować jako inwestycję i odpowiednio rozpatrywać. Niektórzy autorzy akcentują tylko pozytywną stronę audytu. Inni twierdzą, że audyt może mieć także negatywny wpływ. Pozytywny wpływ wewnętrznego audytu polega na możliwości korekt. Audytor rekomenduje bowiem, jakie korekty trzeba wprowadzić i jak można uniknąć błędów i braków. Z korygującym wpływem wiąże się także wpływ szkoleniowy, który jednak w miarę upływu czasu może być zmniejszony efektem tłumienia. Audyt ma także wpływ profilaktyczny i gwarancyjny, przy czym ten ostatni przejawia się w dwóch poziomach: audytowanych podmiotów i odbiorców sprawozdania audytu. W niektórych warunkach audyt wewnętrzny może mieć negatywny wpływ, co oznacza, że działania jednostek audytowanych mogą ulec pogorszeniu. Bardzo srogie czy też intensywne sprawdzanie może bowiem nastroić audytowanych wrogo i tak wywołać efekt dysfunkcyjny.