Internal Auditing is an Asset for Small Companies as well as Large Ones

The term “internal audit” usually inspires two immediate responses. The first is fear: Is something wrong in our organization? Have I done something wrong? Are we out of compliance with current laws and regulations? What will “the fix” cost us? The second is the image of a large FORTUNE 500 company with the people and other resources that an internal audit function requires.

But smaller organizations and even entrepreneurs can perform internal auditing or have it performed in an efficient and cost-effective way that produces positive change and results, improves the business and its underlying processes, and may even make employees happier about the work they do and how they do it.

Most entrepreneurs and small business leaders would make good internal auditors – in fact, most already perform some internal audit activities as a matter of course. They understand their business and very likely helped to create its objectives and business processes. In some cases, they built the business and hired many, if not all, of its employees. They also tend to think intuitively about risks (“What can go wrong?”) and take action to monitor, reduce, minimize or eliminate them. They investigate aspects of their business that concern them, gather facts and objective evidence, and then take the required action.

In this sense, internal auditing already is a key part of many small and owner-managed businesses, particularly the successful ones.

What is internal auditing?

The word “audit” derives from the Latin root meaning, “to listen.” In addition to examining evidence, auditors listen to people a lot in the course of their work. Like listening, auditing is an active skill that takes in information, synthesizes it and responds to it (in this case, in a written audit report).

Unlike external auditors, internal auditors in larger companies work directly with management and its independent audit committee in the broad areas of governance, risk, controls and compliance, helping to review and validate that the organization is operating as intended, managing its biggest risks, and complying with applicable laws and regulations.
Despite its function in large organizations, internal audit is a less-rarefied process than you might think. In fact, The Institute of Internal Auditors (IIA), the global professional coordinating body for the profession, has more than 155,000 members. The IIA formally defines internal auditing as follows: “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

To the pragmatic entrepreneur or small business leader, internal audit may be viewed as a project (or allocation of time) in which capable people examine aspects of the business to determine if they are working as intended, or if improvements need to be made. Findings are reported in a way that either validates the health of those aspects or helps them improve.

An internal audit should result in actionable reports that lead directly to process improvements. Underscoring this point, in a recent survey by a major accounting firm, 57 percent of internal audit executives noted that process improvement recommendations were a “very important” part of meeting management’s expectations for internal audit.

**Why would you want to do an internal audit?**

Generally, smaller organizations have several common reasons to perform an internal audit:

- To understand and verify how activities and processes are actually operating, rather than just thinking you know how they are working
- To look into known problem areas and develop a fact-based action plan to make corrections and improvements
- To verify that critical areas that must operate flawlessly are in fact doing so

For an organization that plans to go public someday, internal audits will help it prepare for the rigorous requirements that publicly traded companies face. Such businesses can begin to create, develop and evolve the processes and controls they will need as they grow and eventually undertake an IPO.

**How should you conduct an internal audit?**

As with any process, when you can organize, standardize and document internal audit, it becomes more efficient, takes less time and produces a more consistent, higher-quality result. To illustrate, let’s say you have identified an area of your business that you want to audit. Here is how a typical internal audit process might proceed:

1. **Decide what you want to achieve.** Why did you select this area? What are you trying to achieve through the audit? What benefits do you expect to derive?

2. **Review objectives and identify risks.** Ensure you understand business objectives for the area, as well as the threats and risks that might obstruct them. Determine if there already are known problems so that the audit can focus on them. In many cases, you will want to see that the main risks are mitigated adequately through the right combination of controls (such as reviews, approvals, procedures, reconciliations, monitoring and supervision).
3. **Plan the audit activities.** Decide what you are going to look at, how much of it you are going to look at, and for what period of time. Identify in advance with whom you need and want to talk. Will you need to have specific information available? If so, request that information in advance.

4. **Complete the work and validate the facts.** Follow the procedures outlined in your planning, but don’t hesitate to change course midstream if new matters are brought to your attention or if early concerns prove unfounded.

5. **Develop a deliverable or report that will drive action.** Create a record of your work as needed. Develop a file of your findings and the evidence that supports them, especially if your findings and recommendations might be challenged. Create a report or action plan from the findings so that the results of your work drive positive and real change.

6. **Follow up.** After a reasonable period of time, make sure your action plan has been carried out, and that recommended actions that were recognized as necessary are being acted upon and resolved. If appropriate, validate the results with corroborating evidence.

7. **Keep learning.** As you perform additional audits, work to continuously improve your audit process. Stay alert for ways to plan better and work more efficiently and effectively. Experiment with different types of reporting to find the one that achieves the best result.

**What areas should you audit?**

Most entrepreneurs and small business leaders are well-qualified to identify the areas worth examining in their businesses, including the biggest threats and risks. In general, the following areas of a small business tend to be especially ripe for internal audit:

- **IT security.** Who has access to your information systems? Do they have access to more information than they need? Could sensitive information be leaking out of your organization, including trade secrets, customer lists, salary information, Social Security information and so on?

- **Business continuity.** If operations are interrupted, how will they recover? How long will the recovery process take? Is a plan in place in the event something happens? Does it cover the most important things we need to consider? What needs to be restored immediately? What can wait?

- **Succession planning.** What would you do if one of your key employees left or could not work for an extended period? Who would take his or her place? Would this new person know what to do? Are there notes, policies or instructions to help him or her?

- **Spreadsheets.** What are our key and critical spreadsheets? How are they controlled? What key decisions do we make based on them? Can anyone access them or change them? Are key formulas locked down and are they adequately password-protected? How do you know you are using the right and latest version of the spreadsheet?

- **Expenditure control.** Just how and where does the company spend its money? Are all expenditures being approved properly and reported accurately? Is the company paying its bills on time? Is it paying the right price and avoiding redundant payments? Is it competitively bidding large items? Is it making any illegal payments? Are any employees operating in a dishonest way?

- **Customer satisfaction.** Do you really know if your customers are satisfied? Would they recommend your company to others? Are they loyal or might they go elsewhere tomorrow for
a slightly better deal? Do they want to buy more from you or use more of your services? Are they aware of everything you are capable of doing for them?

- **Compliance.** Are you adhering to all relevant government regulations and requirements? How do you know? Have you established your own sets of rules and acceptable conduct in important areas? Are your policies being followed as you wish them to be?

- **Data integrity.** Do you make many decisions based upon prepared information, such as inventory reports, overtime information, cash balances, amounts due to vendors, customer credits and information from human resources? Where does this data come from? Is it accurate? How do you know? Is this the right data on which to be making decisions?

**A less demanding alternative**

Some entrepreneurs and small business leaders may appreciate the value of a thorough internal audit but feel they don’t have the time to perform one. While that situation may not be ideal, there are alternatives. One auditing technique that leverages people and time is called “self-assessment.” This technique involves asking people questions or having them complete some form of self-evaluation or self-audit rather than examining a lot of independent information.

Self-assessment is much less rigorous than a traditional internal audit, which not only asks questions and interviews people but also collects and examines information from outside, independent sources (for example, getting bank statements directly from the bank). Nevertheless, it can provide useful information about potential risk areas. In fact, self-assessment may lead to the discovery that a more thorough internal audit is necessary.

**Look ahead – not just back**

Internal auditors are sometimes criticized as merely using hindsight to lay blame or “bayonet the wounded.” By contrast, the most effective internal auditing takes a progressive, forward-looking mindset that can help to identify problems before they happen. To do this, business leaders need to think ahead by asking questions, including:

- Where is my business going? What issues and problems am I likely to encounter?
- What key changes are occurring in the industry in which I operate? Will these translate into changes I need to make to continue to be successful?
- What parts of my business seem to be losing their luster?
- Are there parts of my business that are operating so well that such performance is out of the norm and possibly unsustainable?
- When will the leaders on my staff retire, and who will replace them? When should I start grooming those future leaders?

Whether you decide to perform a thorough internal audit or incorporate internal audit principles into your everyday approach to your business, answering these questions can help you protect and improve your business as it grows.
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One of the key features about Protiviti is that we are not an audit/accounting firm, thus there is never an independence issue in the work we do for clients. Protiviti is able to use all of our consultants to work on internal audit projects – this allows us at any time to bring in our best experts in various functional and process areas. In addition, Protiviti can conduct an independent review of a company’s internal audit function – such a review is called for every five years under standards from The Institute of Internal Auditors.

Among the services we provide are:
- Internal Audit Outsourcing and Co-Sourcing
- Financial Control and Sarbanes-Oxley Compliance
- Internal Audit Quality Assurance Reviews and Transformation
- Audit Committee Advisory

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