

LEAN AUDITING - RETHINKING INTERNAL AUDIT USING LEAN TECHNIQUES TO MAKE A STEP CHANGE IN ADDED VALUE AND PRODUCTIVITY – WHILST MAINTAINING COMPLIANCE WITH IIA STANDARDS – BY JAMES C PATERSON

I am delighted to be coming to Helsinki in February to discuss good practices in audit added value and productivity and to be sharing insights from, and beyond, those contained in the book “Lean Auditing”

Here is a brief overview of lean and lean auditing to help give a brief flavor of some of the topics we will be discussing at the workshop. *Please note this is only a very brief overview of some of the key points and their practical application to internal auditing:*

What is lean and what can it offer us?

From its origins in car manufacturing in Japan where both productivity and quality were improved, lean techniques have now been successfully applied in a range of sectors outside of motor manufacturing (e.g. in white goods and pharmaceuticals manufacturing) and, increasingly, in service sectors (e.g. airlines, healthcare). Typical benefits obtained from lean ways of working include:

- Reductions in: Defects, Lead times, cost, inventory and waste;
- Improvements in: Customer satisfaction, Productivity, Capacity, Responsiveness and Quality.

“It needs less of everything to create a given amount of value, so let’s call it lean.”


Lean ways of working have also been used in relation to finance, HR and IT. And the application of lean to internal auditing can be thought of as just a continuation of this evolution. However, the key to success is to understand how to intelligently apply lean principles and techniques whilst respecting key IIA standards. The result is a “progressive” approach to internal auditing that may match the views of many readers, with the benefit of having a solid underpinning in theory and practice in relation to how to balance efficiency with quality and value.

Key principles of lean

The 5 key principles of lean can be summarized as:

- Understand value from the point of view of the customer;
- Identify the value stream;
- Create activities that Flow;
- Pull through to deliver “just in time”;
- Aim for perfect process without waste/rework or bottlenecks.

It is important to recognize therefore that lean is not simply about reducing costs although managing and reducing costs is a by-product of lean ways of working. This also means that *working in a lean way is often a much more positive approach to auditing than most people realize* and this is a regular feedback theme I receive from those who attend lean auditing workshops.



More lean techniques to achieve these principles in practice are contained in the Lean Auditing book, but here are some of the practical applications and consequences of lean ways of working to internal auditing:

Being clear who are the key customers of our audit work

As one head of audit explained to me:

“When I first started out in audit, I was more interested in the value I added to the business managers I was auditing. One, it's an easier life, you keep people happy who you are dealing with 95% of the time, but over time I see it's a mistake to forget that you've got competing interests in terms of what other stakeholders might want”.

Lean principles give us insights into how to approach adding value in practical terms so auditors can prioritise the work they do – also avoiding dis-satisfiers that can undermine all the good work we do.

Being clear what those customers really want (and what they do not want).

When considering the audit report, one head of audit I interviewed explained:

“A report is only valuable when management and the board use it and see that it helps them. If they briefly look at it and then put it aside, then it is basically useless ... On the other hand, if they look at the report and say 'yes, this is something I think will help me manage my business' or if they discuss the contents of the report with other parts of the business, then it is a good sign. My measurement of the value of an audit report is not about the contents or the number of issues raised *but by how management and the board use it to manage their business.*”

Very often therefore lean ways of working encourage audit teams to revisit not just the length of audit reports but also the way that findings are expressed so that they can have more impact/business relevance.

Pay close attention to identifying Muda (waste)

A key founder of lean ways of working, Shingo Shigeo, said: “The most dangerous waste is the waste we do not recognize”.

The following examples illustrate some of the ways in which a lean approach can benefit and audit team.

Resource assignments appropriately:

One head of audit explained:

“We are being more flexible but also more challenging on the amount of time we spend on assignments. We will accept a more diverse range of how much time we will spend, the aim being to more closely match assignment lengths to the likely value add.”

Typically a lean auditing approach will reduce the budgeted number of days that are custom and practice in the audit team and speed up the delivery timelines planned.

Plan assignments carefully

One interviewee explained:

“Planning an assignment is key because when I see things going wrong, including delays in delivery, it is often because we didn’t think enough up front. It can be as simple as not recognizing a key contact is travelling or on holiday for 2 weeks during the assignment.

Unless people have really thought about what they want and sufficiently planned and been rigorous in engaging the business, problems will arise”.

Another interviewee explained:

“Good audit departments put a lot of effort into thinking about and agreeing the scope of their audits so they are addressing important points; and as a result key findings will then be meaningful to the organization”.

Lean ways of working also encourage audit to encourage management openness about issues and to be clear about how to handle these in the audit report; after all it adds little value to be told by management that an audit report is largely telling them what they already know! It also helps relationships with management to give them credit for issues that have been identified and are being worked on.

During audit assignments there are other important areas productivity that can often be improved:

Testing:

Chris Baker the former technical director of the IIA UK explains:

“IIA Standards say that you need to gather sufficient evidence and have sufficient relevant information to be confident about what you are concluding and in order to be able to express an opinion. However, that’s often translated into a whole load of advice about how many records you need to look at and how many tests you need to do to substantiate everything, when, in point of fact, when we are focusing on risk and adding value it should be different from that. For example, it’s wrong to stick to sample requirements in a rigid way”.


The key message is to better understand when to continue testing, change the testing approach or to stop testing. In the book Richard Chambers explains: “I think part of our problem as a profession is that sometimes we have a tendency to over-audit. Sometimes we do things in the audit process and try and validate things that aren't really going to be important”.

Root cause analysis:

With the time saved from more intelligent testing, additional added value can be derived from a solid root cause analysis (which is also a series of techniques developed by lean ways of working).

One interviewee commented:

“I think that reporting the findings in terms of symptoms and then stopping is ridiculous. If you just report that reconciliations are not being done, without asking more questions that may be needed to identify the root cause, the issues don't go away. You're actually not curing the patient. You're just pointing out the problem”.



A key clue in relation to whether root causes are being properly identified is to consider how many issues seem to repeat from year to year. Another is to challenge the idea that there is a single root cause for each audit finding; this is never the case as we will see in the workshop.

Driving value in effective Audit Reporting:

Re-writing audit reports is often a time when the momentum of the audit can slow down. Lean ways of working challenge us to “head off” possible issues with the report findings before they are spotted in the audit report. One senior auditor explained:

“Before we put pen to paper and waste our time, let's write up a list of findings and first of all decide whether we agree these are all important.

After that we can look at the findings and the proposed corrective actions and start to see whether there are patterns, so that they can be combined.

This approach makes sure that audit reports are more focused, with less need of rewriting. It also helps you to combine points making reports as concise and readable as possible, and also helping stakeholders better judge the relative significance of what is being found”.

The key message is to think carefully about what is important in the audit report and to focus on that, avoiding the demotivating and wasteful situations when audit reports are extensively revised or rewritten.

Audit team culture

The book provides examples of ways of working that improve the pace and energy of audit team assignment delivery and encourage a collective and proactive approach to learning after each assignment, driving improvements in both value orientation and delivery. Paradoxically this can include revisiting traditional metrics/key performance indicators and considering whether these actually drive productivity or in fact focus audit time on the wrong things (for example making up time sheet records to align with what is expected!).


Norman Marks offers the following challenging observation, but very much in line with the insights from the book:

“The danger is that we have been trained not to think when auditing in the old way. We've got to break that. When you hire people you need to train them. Not only do you have to train them to think but you have to break the shackles that bind them. They are actually weighed down and handcuffed and chained to stop them from thinking for themselves, and exercising their own judgment. We've got to tackle this as a profession”.

Final reflections

My hope is that the greater understanding of lean principles can help the internal audit profession to become more confident in approaching our internal audit work in a professional but pragmatic way so we can deliver key insights productively without feeling like we are “cutting corners”.

Writing this article has felt like squeezing a gallon into a pint pot, and may have opened up as many questions as it has answered. However, I hope that those reading this article are curious to learn more about lean ways of working and how these can apply to internal auditing, perhaps starting by



ordering a copy of the book (Lean Auditing – ISBN 9781118896884), looking at my website www.RiskAI.co.uk, or making contact with me at: jcp@riskai.co.uk, either to share their insights or to sign up to attend the lean auditing workshop in February 2018 in Helsinki!