



Operational Audit for Improving Future Business Operations

* Dr.S K Jha

* Faculty, Management Programme, L N Mithila University, Darbhanga

ABSTRACT

Operational audit is basically to find out whether all operations of the business in the areas of manufacture, quality control, purchase, storage, transportation, marketing, personnel, financial services etc. are being carried in properly. It is to point out any lacunae in the operations of any of its activities. It is a systematic appraisal of the effectiveness of major functions of an organisation against corporate and industry standards and norms and thereby identifying areas capable of being improved upon. It becomes easier if there is a plan against which the efficiency of various operations are measured and reported upon. It shall report the validation of the plan as well as the performance. An attempt has been made in this paper to discuss various facets of operational audit

Keywords : Cost – Benefit Analysis, Efficiency, Factors of Production, Operational Activities

BACKDROP

There have been times when the business was being conducted by a single person who only provided land, capital and enterprise but also worked himself and there was no one to share the risk in the business operations. There were times when the scale of business was so small that one person could do all the jobs required in business operations alone. Today even a panwala finds it difficult to operate his shop alone; he also requires assistance of a relief from time to time at least in labour if not in providing other factors of production.

In today's times when the scale of operations of a business has become quite wide and all the five factors of production are provided by different people and even a single factor of production is provided by more than one person, it is difficult to control all the operations of business by one person alone. In other words, today there is a total divorce between capital and management and hence there is a need for control. As the span of control enlarges, the control systems have to come to play their role in the drudgery of day-by-day operations and partially be taken over by the control mechanism. When for one manager, it is not possible to foresee all the operations in the business, he requires somebody else to report to him, the activities involved in other operations which he himself is not supervising. Hence, the operational audit comes into picture.

Operational Audit to Improve Future

Since independence India has not achieved the desired economic development as planned. Regional and Social imbalances have been continued over the years, leading to social unrest in different part of country. In the industrial field there is an alarming growth of sickness of industries large amount of resources of banks and financial institutions are involved in the rehabilitation of sick industries. In the unorganized sector also sickness is reported. Large amount of loans are being written off by banks and financial institutions arising out of sickness and inability to recover the loans.

The term operational audit is relatively of recent origin. Operational audit means a systematic appraisal of performance. According to Federal Financial Officers Institute in Canada, operational audit is "a systematic independent appraisal activity within an organisation for a review of the entire departmental operations as a service to management. The overall objective of operational audit is to assist all levels of management in the

effective discharge of their responsibilities by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed." It is also defined as "a comprehensive and constructive review of organisational structure or components thereof, that is, the method of operation and use of physical facilities."

Operational auditing has been defined by the Institute of Internal Auditors, Inc. as "As operational audit is a future-oriented independence, and systematic evaluation performed by the internal auditor for management of the organisational activities and controlled by top, middle and lower-level management for the purpose of improving organisational profitability and increasing the attainment of the other organisational objectives; achievement of programme purposes, social objectives and employee development. Areas in which efficiency and effectiveness may be improved are identified and recommendations made that are designed to enable realisation of the improvements. The measure of effectiveness includes both an evaluation of compliance with prescribed entity operational policies and of the adequacy of them. Financial data may be a source of evidence, but the primary source is the operational policies as related to the organisational objectives. Included are an evaluation of the management control system in terms of existence, compliance and relevance to the attainment of organisational objectives."

According to A.I.C.P.A., "An operational audit involves a systematic review of an organisation's activities, or of a stipulated segment of them, in relation to specified objective. The purpose of such audit may be (a) to assess performance, (b) to identify opportunities for improvement, and (c) to develop recommendations for improvement for further action." Thus, an operational audit may be performed on the entire organisation or a portion of the organisation. The portion of the organisation may be a department, a branch, a division, a function (like purchasing, marketing, etc.) or any other unit.

Objectives of Operational Audit

Objectives of operational audit are:

- To evaluate performance: Operational audit was originally conceived to evaluate the performance. In evaluating performance, the auditor measures the efficiency, effectiveness and economy with which various operations are performed.
- To appraise the organisation structure: An operational

auditor has to evaluate the organisational structure of the concern in the light of its objectives. He has to see that lines of authority and responsibility are clearly established, there is no overlapping of authority, span of control is reasonable, etc.

- To evaluate controls: An operational auditor evaluates various controls to judge the effectiveness of these controls to achieve organizational objectives.
- To appraise the objectives and plans: The scope of operational audit may be extended to include the evaluation of business goals and objectives. Here an operational auditor has to see whether organizational objectives are clearly spelt out and properly communicated to the operating staff and are properly understood by them.

An Operational Audit may be conducted

- ✓ To see that the financial accounting records have been properly designed and maintained to furnish the management with timely information to help them for judging to what extent the profitability goals have been achieved.
- ✓ To see that the internal control system has been designed from the point of view of achieving better efficiency and whether the same have been functioning effectively.
- ✓ To study the credit control system for suggesting better measures where considered necessary.
- ✓ To study whether some expenditure of sizeable magnitude could have been avoided and reduced.
- ✓ To study whether expenditure has remained within the budgetary provisions.
- ✓ To study whether scrap/loss of material have remained within the permissible limits etc. and the methods of their disposal are bringing adequate revenue.
- ✓ To study whether operations are in tune with the management objectives and to carry out the cost-benefit analysis for helping the management in taking decisions.

Coverage areas of Operational Audit

Operational audit covers all operations of business whether financial or otherwise. Hence, the scope of operational audit includes all activities of business which could include the following:

- Design
- Production
- Purchase
- Storage
- Transportation
- Quality control
- Repairs and maintenance
- Selling and Distribution
- Personnel
- Research and Development
- Financial management
- Computer Division
- Training and Development.

Conductance of Operational Audit

Operational audits concerned with the objectives of efficiency and effectiveness. There are many reasons for performing an operational audit: compliance with policies and procedures, excessive sales returns, proposed product mix, equipment down time or personnel turnover etc. Therefore, an auditor must establish the scope of an operational audit before formulating the approach to initiate an operational audit. This step will determine the extent of the scope of audit. The second step shall be to understand the auditee's operation, its purpose in the total environment of the entity, its history, its image, its staff, their skills and competence and its reporting path. The reporting path is of very critical importance because this path is the communication route along which, the audit results and conclusions will flow.

Following steps should be taken in conducting operational audit:

- i. Acquainting himself with technicalities of the operations.
- ii. Familiarisation with the actual operations and operating

problems.

- iii. Analyses and appraisal of the control systems being followed in that area of activity.
- iv. Adequacy of the controls being exercised in the conduct of the activity.

For this purpose the operational auditor could ask himself the following questions before he proceeds further:

- ✓ Is this control of help to the management of the operation which is being audited?
- ✓ Is the cost of maintaining the control justified by the value to the business?
- ✓ Is work being done in one location that is being duplicated in another? If so, where is the better place to do it?
- ✓ Are duplicating controls maintained in different locations?
- ✓ Are good and bad situations brought to management's attention as the basis for management action?

The prime records to be obtained in an operational audit are the organizational chart of the function/operation, applicable policies, guidelines and procedures etc. These will outline each employee's responsibility and authority. The function's/operation's performance reports for the reasonable period prior to the audit should be reviewed to do trend analyses or the critical analyses. These analyses or reports could indicate potential critical areas such as over- or under-staffing, non compliance with corporate policies and procedures, weaknesses in internal controls, or inadequate job rotations etc. These indications could help the management auditor in determining scope of investigation and areas of potential improvement. Reports must be based on facts, informative, submitted in time and directed to the proper levels of management.

The Operational Auditor

Operational audit can better be conducted by a person who is concerned with the day-to-day operations of the business. Hence only the person who is acquainted with the day-to-day operations of the business can do justice while conducting operational audit. Hence this can better be done by a person who has been conducting the various operations within the company.

Operational audit is concerned with all the operations of business activity involving knowledge of technology, techniques, purchases, sales, transportation, manufacturing, quality control, research and development, financial management, storage, personnel, computers etc. Hence no single qualification can be prescribed for conducting operational audit. Having a multi – disciplinary approach and persons having adequate qualifications to work in all the activities of the business should be in the operational audit team and this could be headed by any one of them.

Assurance of Economy, Efficiency and Effectiveness

The purpose of operational audit is to assure management that operational objectives are valid and operational control information is valid and reliable and that the operational activities are effective and efficient. It is concerned with the pursuit of economy, efficiency and effectiveness through out all operations. Hence in operational audit the following aspects are very important:

- Discussion with the operating people to understand the proper sequence of operations all of which may not be found recorded in document and workflow statement.
- In operational audit it may be necessary to draw minute details through chart and diagrams of the flow of product process for indication of the check points in audit.
- Discussion with the engineering personnel to get an insight into the engineering aspects of operations.
- Visit of the operating areas to get familiar with the physical operating details.

Concluding Remarks

Operational audit is concerned basically with all operations of a business whether financial or non – financial. Operational audit is basically to find out whether all operations of the business in the areas of manufacturing, marketing, personnel, financial services etc. are being carried out properly. It is to point out any lacunae in the operations of any of its activities. It aims at improving future business operations by concerning the auditor with all aspects of management. The audit, through appraisal review and evaluation of the operating control records and management information systems aims at better performance to achieve better profit.

An operational auditor has to have a multi-disciplinary approach and persons having adequate qualifications to work in all the activities of the business should be in the operational audit team and this could be headed by any one of them. Operational auditor should be a person who has been connected

with the various operations of the company. The frequency of operational audit is continuous and at any given time one or other activity of the business should be under examination by the operational auditor. However, effort should be made that all the activities of the business have been covered by operational audit once in a year if not more often depending upon the requirements of the business. In certain cases certain activities could be covered once in 2 to 3 years.

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