Internal / External Auditing

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ABSTRACT

Regular auditing of health, safety and loss control programs is becoming an increasingly common practice among Australian mining companies for measuring the effectiveness of their safety management systems. Internal audits using company employees are preferred by some, while external audits made by outside contractors are preferred by others. Some use a combination of both.

Bias, cost and credibility are the most important considerations influencing management's choice between internal and external auditing. This paper considers the advantages / disadvantages of each against a background of preferred auditing practice.

INTRODUCTION

The need for adequate safety programs to control the incidence of workplace injury and disease has long been accepted as a necessary part of business activities. Initially these programs were driven by worker's compensation legislation and more recently by management's recognition of the link between a safe and healthy workforce and optimum profits.

Some organisations, influenced by loss control management thinking over the last decade, have expanded the scope of their safety programs to include all accidental losses affecting profitability.

"Safety" according to one widely-accepted definition is "control of accidental loss". Safety management therefore can be said to be "the taking of those actions that increase management control so as to reduce accidental losses from harm to people (injury and disease), damage to property and loss to process."

An increasing number of managers are now using formal loss management audits to measure the effectiveness of their safety programs by evaluating the extent and quality of management control. Properly used, the safety audit encourages a pro-active management approach focussing on self regulation and self interest as its prime motivators.

A 1991 survey of safety management effectiveness in Australian mining companies showed that Queensland coal producers were then in the vanguard of those companies making regular evaluations of their occupational health and safety management systems. Of the Queensland coal producers responding to the survey more than 70 per cent said they were making regular safety audits with about 80 per cent of those using self-audit programs and 20 per cent using commercially-available ones.

Auditing is a widely accepted management practice to verify that critical business activities are managed in effective and profitable ways. Neither managers nor shareholders would expect a balance sheet to provide an accurate appraisal of their organisation's financial health unless based on properly audited accounts. Likewise, managers' verification of the effectiveness of their safety, health and loss control programs must also be deemed inadequate in the absence of regular evaluation using soundly-based audit systems.

Safety audits can be made by company employees - referred to in this paper as "internal audits", or by using outside consultants or contractors - referred to as "external audits". Some companies use both.

Three words can be used to describe the main factors influencing management's choice between these alternatives - "bias", "cost" and "credibility". Before discussing these issues it is well to consider the

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context in which safety audits are made.

BACKGROUND

Purpose

The purpose of the safety audit is to provide management with the means for a systematic evaluation of each element of an organisation's safety programs to determine the extent and quality of management control.

Objectives

The objectives of the safety audit are to provide:

1. measurements of the management work being done to control accidental occupational losses.

2. measurements of management compliance with established program standards for each element of the safety program at a specific time in its development.

3. a means to compare present safety management performance with past and/or target performance.

4. a means of appraising individual and group safety performance.

5. an evaluation of the safety programs' strengths and weaknesses.

6. a blueprint for the development and implementation of action plans to build on program strengths and correct its weaknesses.

7. tangible evidence of management's concern for the safety and health of its workers and the protection of company assets.

8. documentary evidence of value in employee and public relations.

9. documentary evidence of "due diligence" of potential value in case of litigation.

10. documentary evidence in the case of service companies e.g. "contractors", to demonstrate to client companies that their safety programs are being responsibly managed.

Audit types

There are two main types of safety audits :

1. Compliance audits used to compare actual company safety practice with either established management performance standards or with legal requirements i.e. comparing what is being done with what should be done to comply with company standards or with the law. Examples of compliance audits are:

1.1 general physical conditions audits of all company assets.

1.2 fire prevention and fire control audits.

1.3 occupational health audits.

1.4 engineering audits,

2. Comprehensive audits used to evaluate an organisation's entire safety, health and loss control programs. They may be initial or so-called "baseline" audits to measure initial safety program effectiveness, "follow-up" audits to monitor progress of program development, or "check" audits to verify the results of an independently made audit.

Characteristics

The main characteristic of a soundly-based audit system is that it should not only be credible, it must be seen to be credible by managers, employees and other auditors. It should be based on objective criteria able to provide unbiased and consistent results.

The audit instrument

The most widely accepted audit systems are those built around the loss programs of organisations excelling in one or more elements of loss control management, as measured by consistently low loss rates i.e. "best practice".

What then are the identifying characteristics of a world-class safety audit system?

1. It should be based on best practice; i.e. it should contain the essential key elements selected from successful loss management programs.

2. It should be flexible enough to cater to the special needs of a particular business and the legal framework in which it operates.

3. Answers to audit questions should where appropriate be based on objective measurement rather than subjective judgement by using statistically-valid techniques of actual count, random sampling and trained professional judgement.

4. It should emphasise pro-active management ; i.e its main focus should be on the positive management initiatives in place to control loss, with subordinate emphasis on the losses themselves.

5. It should be subject to regular peer review to keep it abreast of developments in legal requirements and/or improvements in loss control management thinking.

6. It should be well documented to the extent that trained auditors evaluating the same work-site at the same time will produce closely repeatable audit results.

7. It should provide the means of evaluating not only an organisation's management systems to control the health and safety of its workers but also its programs to control other operational losses from property damage, waste, production downtime, defects in product and service quality, security losses, environmental damage and those near accidents with the potential for serious loss.

The audit audience

For maximum effectiveness the audit results should be aimed at three main audiences - the management team (line and staff managers),workers (award and contract employees) and shareholders.

There is a common misconception among senior managers that information about the audit outcome should be limited to senior managers. In companies encouraging employee participation and involvement in decision making the audit process and outcome deserves and should have a much wider audience.

Award employees, because of their potential exposure to unsafe and unhealthy working conditions, are

the most important stakeholders in safety and health matters. Their involvement in the audit and its outcome provides management with the opportunity to send employees a powerful message recognising their part in the job of improving workplace safety.

The exclusion of employees from the audit process will send an equally powerful negative message that workers are not considered part of the management function and can't be trusted with the knowledge that some parts of the workplace and some activities may be unsafe.

Some companies are using their annual reports to advise shareholders and the wider community of safety awards from positive audit outcomes, thus sending the message that the company is dedicated to continuous improvement in the quality of its management as it affects workplace health and safety and the protection of shareholders' assets.

Making the audit

The outcome of the audit depends for its success not only on the quality of the audit instrument but on the way it is used.

Organisations can conduct safety audits of their operational units in three main ways:

1. by using self-audit programs using corporate, operating or staff employees. They need have no formal audit training, simply following instructions contained in the audit instrument.

2. by using properly trained and accredited employee auditors using a commercially available audit instrument with audit results subject to external quality assurance checking.

3. by using properly selected, trained and accredited external consultants or contractors, also with external quality assurance checking.

Whether internal or external auditors are used, the administration of the audit should conform to the following guidelines:

1. Auditors should ideally be independent of the organisation and of the management unit being audited.

2. Auditors should be chosen for their impartiality and freedom from bias.

3. Auditors should have high ethical standards as they will be exposed to proprietary and sometimes sensitive information during the audit.

4. Audits should be made by specially selected, trained and accredited auditors, subject to refresher training and re-accreditation at regular intervals.

5. The auditor will measure the degree of compliance with audit criteria using recognised sampling techniques as necessary.

6. Using appropriate audit guidelines to minimise bias, the auditor will seek to verify audit answers by document and record check, by physical inspections of the workplace, plant and equipment, and by interviews with employees at all levels in the organisation to confirm that safety management practices are not only in place but are working.

7. All audits should be subject to checking, preferably by a highly experienced, independent auditor to ensure uniformity and consistency of approach between auditors and audit locations, and as part of a continuing education program to refine auditing skills.

8. Auditors should report audit results to management with a minimum of delay, presented in the language of management and expressed in understandable terms.

9. The audit outcome summarising its results, findings and recommendations should be made known to employees as soon as known by management.

The safety audit is not an end in itself. It is simply a tool to measure the effectiveness of the safety program at some stage in its development. Its real value is not realised until management takes effective action to build on the safety programs' strengths and correct its weaknesses, so increasing the level of management control.

INTERNAL AND EXTERNAL AUDITING

The main issues to be considered by managers making a choice between internal and external safety auditing are:

1. the elimination of bias, necessary to produce reliable and accurate audit outcomes.

2. completion of the audit at the lowest cost consistent with achieving unbiased, accurate and credible results.

3. achieving results with maximum credibility among managers, employees and other auditors.

Bias

The outcome of any audit will be more accurate and credible when free from bias. It is difficult to eliminate bias entirely but certain conditions have the potential to increase or reduce it.

Bias will generally be <u>increased</u> when:

1. a self-audit program is used depending for its answers on subjective judgement.

2. the person making the audit has had no previous training in auditing practices.

3. the person making the audit is responsible for or reports to a person responsible for operational performance of the audited unit.

Bias will generally be <u>decreased</u> when:

1. external, accredited safety auditors are used in the context of a client-agreed code of professional conduct.

2. internal auditors are selected from among corporate or staff management personnel organisationally separate from and independent of the operational unit being audited. Safety, fire, security and environmental professionals, for example, are more likely to produce unbiased results because of their more neutral positions in the organisation compared with production staff.

3. an audit instrument is used, with clear guidelines for audit scoring, that require validation by document and record checks, physical conditions inspections of the entire work site and interviews with a statistically-valid number of management and award employees.

4. a check of audit scoring, validating evidence, and the audit report is made by an experienced, independent external auditor.

5. auditors, whether internal or external, have had previous safety auditing experience.

Cost

Compared with the use of employees as internal auditors the hiring of external auditors from among consultants or contractors will be a significant additional cash cost to the organisation.

While the use of internal auditors need not add to cash costs there may be additional indirect costs in diverting them from their normal employee duties. A comprehensive audit of an operational unit , for example, might take five days to make with five to ten additional days to check documentary evidence, write the audit report and have a quality assurance check made by an external auditor.

Whether internal auditors are used the manager responsible can control costs by holding a pre-audit meeting with auditors to agree the scope of the audit, the time required for its completion and the items to be included in the audit report.

Credibility

Bias and credibility are less important considerations in making compliance audits. Checking of physical conditions, for example, may require no more than counting such items as the number of properly charged fire extinguishers in each location. Such checks can and should be made by internal auditors. Comprehensive audits on the other hand require the examination of safety program elements concerned with management leadership and administration where communication of policies and coordination of programs are important aspects of the safety program that are more open to interpretation and judgement. Trained external auditors in these circumstances are less likely to be affected by bias and more likely to be given credibility by employees.

Some companies encourage the involvement of employees at all levels in the audit process. These workers assist in making physical conditions checks and sit alongside managers in answering audit questions. They participate in interviews to validate audit answers. Later they join with management to design and implement action plans and sit on committees to monitor progress for continuous improvement, the legitimate goal of the audit process. The sense of ownership in the audit outcome increases credibility among workers and their confidence in the audit process.

Other Issues

Other issues will influence the choice between internal and external auditors. Internal employee auditors may be preferred for compliance audits because of their local knowledge of the industry or plant. This may be advantageous where engineers, fire and safety specialists, for example, have special technical knowledge of plant and equipment.

Useful insights into the extent and quality of the management function are obtained through the audit process and some managers may see the use of internal auditors as a way to keep this information "in-house". At the same time they might see merit in retaining the training value of the audit for the development of employee auditors with management potential.

There is often a mistaken perception among senior managers that there is a close correlation between "what should be done" to meet company standards and legal requirements for safety and "what is being done". Under these circumstances internal auditors may be exposed to corporate politics and both peer and seniority pressures to preserve that perception. External auditors are unlikely to be so affected.

Managers and employees, both important stake holders in the audit outcome, will be vitally interested in its results. There is a useful employee relations value in reporting the results of the audit to senior management as soon after completion of field work as possible. Employees, through their involvement, will know when the audit was made and management credibility will suffer if the audit results are not made known to them in a reasonable time. Given the time required to verify evidence, collate the results

of employee interviews, prepare the final report and allow for external quality assurance checking, no more than four weeks should be allowed to elapse before announcing the audit results to the workforce. Internal auditors often find it difficult to meet such a deadline at the same time as managing their other duties. External auditors on the other hand have a vested interest in completing the audit and reporting its results promptly so they can get on with new business.

An external auditor with an extensive repertoire of outside audit experience can often bring a fresh and more disciplined approach to the audit process. The combination of proper training, independence and diverse audit experience provides a sound basis for achieving an objective, bias-free, credible audit outcome, unaffected by corporate politics and other organisational pressures.

CONCLUSION

In the making of safety, health and loss control management audits there are legitimate roles for both internal and external auditors.

Initial ("baseline") audits should be made by external auditors to provide an unbiased, credible foundation on which the safety program can be built.

Subsequent follow-up audits can be made by either internal or external auditors. When internal auditors are used, external auditors should be used for every second or third audit to check these internal audits for accuracy, consistency and objectivity.

At the highest levels of safety program achievement, external auditors should make the audit or take charge of the audit team to avoid questions of conflict and bias. Some commercially available audits packages make this a requirement for external recognition by the jurisdictional authority.

Whether internal or external auditors are used, the results of the audit will gain credibility when award employees participate fully in the audit process, know its outcome and share with managers the planning and implementation of action plans for continuous improvement for the systems of safety management in the organisation.

Management's job is therefore to strike the appropriate balance between these issues, consistent with achieving an accurate, un-biased and credible audit outcome at least cost and with maximum effectiveness for the organisation.

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3. Answers to audit questions should where appropriate be based on objective measurement rather than subjective judgement by using statistically-valid techniques of actual count, random sampling and trained professional judgement.

4. It should emphasise pro-active management ; i.e its main focus should be on the positive management initiatives in place to control loss, with subordinate emphasis on the losses themselves.

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The audit audience

For maximum effectiveness the audit results should be aimed at three main audiences - the management team (line and staff managers),workers (award and contract employees) and shareholders.

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Award employees, because of their potential exposure to unsafe and unhealthy working conditions, are

the most important stakeholders in safety and health matters. Their involvement in the audit and its outcome provides management with the opportunity to send employees a powerful message recognising their part in the job of improving workplace safety.

The exclusion of employees from the audit process will send an equally powerful negative message that workers are not considered part of the management function and can't be trusted with the knowledge that some parts of the workplace and some activities may be unsafe.

Some companies are using their annual reports to advise shareholders and the wider community of safety awards from positive audit outcomes, thus sending the message that the company is dedicated to continuous improvement in the quality of its management as it affects workplace health and safety and the protection of shareholders' assets.

Making the audit

The outcome of the audit depends for its success not only on the quality of the audit instrument but on the way it is used.

Organisations can conduct safety audits of their operational units in three main ways:

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2. by using properly trained and accredited employee auditors using a commercially available audit instrument with audit results subject to external quality assurance checking.

3. by using properly selected, trained and accredited external consultants or contractors, also with external quality assurance checking.

Whether internal or external auditors are used, the administration of the audit should conform to the following guidelines:

1. Auditors should ideally be independent of the organisation and of the management unit being audited.

2. Auditors should be chosen for their impartiality and freedom from bias.

3. Auditors should have high ethical standards as they will be exposed to proprietary and sometimes sensitive information during the audit.

4. Audits should be made by specially selected, trained and accredited auditors, subject to refresher training and re-accreditation at regular intervals.

5. The auditor will measure the degree of compliance with audit criteria using recognised sampling techniques as necessary.

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INTERNAL AND EXTERNAL AUDITING

The main issues to be considered by managers making a choice between internal and external safety auditing are:

1. the elimination of bias, necessary to produce reliable and accurate audit outcomes.

2. completion of the audit at the lowest cost consistent with achieving unbiased, accurate and credible results.

3. achieving results with maximum credibility among managers, employees and other auditors.

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2. the person making the audit has had no previous training in auditing practices.

3. the person making the audit is responsible for or reports to a person responsible for operational performance of the audited unit.

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1. external, accredited safety auditors are used in the context of a client-agreed code of professional conduct.

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CONCLUSION

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At the highest levels of safety program achievement, external auditors should make the audit or take charge of the audit team to avoid questions of conflict and bias. Some commercially available audits packages make this a requirement for external recognition by the jurisdictional authority.

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