PROFIT BUILDING AUDITS:
FOR PROFITING, PREDICTING, AND IMPROVING:

By: J.P. Russell
5980 East Bay Blvd., Gulf Breeze, FL 32561
www.JP-Russell.com

SUMMARY:
This paper is about auditing at higher cognitive levels to improve the business and better meet customer needs in a competitive environment.

KEY WORDS:
Auditing
Effectiveness
Best Practices

INTRODUCTION:
Audits are investigations that result in evidence. This evidence is used to determine compliance or degree of compliance against specified requirements. In many cases the requirements are national or international standards that have been issued to protect the public well-being. An independent someone must go and see for themselves that people are following the rules. It is expensive, but we don't know any other way to do it. How do we know that the drug company conducts all the tests, the airline company performs all the scheduled preventive maintenance, the food company follows good clean room procedures, unless we check. With an army of government and internal company compliance auditors, we can sleep a little better at night.

Many companies conduct internal audits because it is required. It may be required by a customer or it may be requirement for maintaining their license, registration, or certificate. To verify compliance, auditors seek evidence that the system design (documented, established) is adequate, implemented, and maintained. Conducting the internal audits in advance of the external auditors also helps organizations prepare for the external auditors. Organizations are expected to maintain a state of readiness such that their system could be evaluated at any time.

When audits are done solely for compliance purposes, management's expectations are low. They may view audits as the cost of doing business or a necessary evil. They may only see audits as a requirement that limits their ability to control costs and compete in the market place or their industry sector. Management may believe that the internal audit program reduces the risk of external auditors reporting problems that create more bureaucratic headaches. It is always easier to address problems when third party organizations are not involved. Historically, management has accepted the high cost of the internal audit programs that result in few tangible benefits to the organization. A Vice President of a regulated company explained to me, auditing is the cost of appraisal. The lack-luster performance of many audit programs is a self-fulfilling prophecy. If you only expect the auditing function to determine the extent of compliance or noncompliance to external standards, then that is all you are going to get.

PROFITING:
Yet it is relatively easy for organizations to go beyond compliance and reap huge rewards. The investigative techniques for determining compliance can also be used to identify areas for improving

effectiveness. The pool of data used to verify compliance can also be used to identify opportunities for benefiting the organization.

When we move beyond compliance, the audit objectives may be:

- Determine if the system design is adequate to achieve business objectives
- Identify performance weaknesses and strengths
- Verify process responsiveness to customer and business needs

When you transform to evaluating process performance, management thinking changes. Now auditing may be viewed as a management strategy for benefiting the organization and preventing potential problems. With almost the same resources you can receive a lot more valuable information. Internal and supplier audits can be a valued-added service instead of being a watchdog or tattletale activity. We can audit for profit by linking observations and issues to dollars, the universal yard stick. A reason-pain matrix [*After the Quality Audit*, 2nd edition, 2000, Chapter 2] can be used by auditors and management to assess importance and priorities of audit results. Management can also quickly determine if audits are contributing to or if they are taking away from the bottom line.

Audit programs should be able to carry their own weight. At the very minimum they should find savings equal to the cost of the service. The optimum would be for the audit function to be a partner in generating ideas for improving the profitability or conserving organizational resources (if nonprofit). The audit group can become a contributor to management of organization assets whether it be reduced costs, identification of opportunities, or avoiding risk. Auditing folks should link up with account folks to better quantify auditor observations and to monitor audit program performance.

Today, management is also interested in non-financial issues that affect the organization such as the work environment, ergonomics, or relationships with the community and diversity. When conducting Profit Building Audits (improve performance), auditors may see or hear non-financial concerns that need to be passed on to management to address.

To audit for profit, auditors need to look beyond the rules and audit to determine effectiveness and efficiency of a process. But how do we determine effectiveness or whether an activity is effective? Effectiveness is another word that has been popular but used with little understanding of it's meaning. Some new definitions that provide some direction are:

Effectiveness [*After the Quality Audit*, 1996, pages 104-106, pg 125]: of an action (activity) has two components: (a) it is achieving the desired result, and (b) the process is capable and efficient. An equilibrium must be achieved between output goals and the process that provides the output.

Effectiveness [*The Quality Audit Handbook*, 1999, page 113]: is the degree to which objectives are achieved in an efficient and economical manner.

Effectiveness [ISO 9000-2000]: the extent to which planned activities are realized and planned results achieved.

An audit that examines effectiveness and efficiency does not substitute for management's responsibility to monitor area or system wide performance. Rather, audits provide an additional source of information to assist management in their evaluation. [*The Quality Audit Handbook* page 114].

First, auditors may scan an area to determine if there are rules and if people are following the rules. When auditors audit for profit, they need to scan for effectiveness and efficiency of a process. When conducting process performance audits, auditors should look for the symptoms of ineffectiveness and inefficiency. Common poor performance indicators are: Redoing (repeating), Waiting (delaying), Rejecting (wasting), and a Work-around (bypassing). Auditors should examine questionable performance indicators (the symptoms) to identify areas that may be improved. Improved processes should lead to improved profits.

For Example:
Why is the nonconforming part still in the hold area after 6 weeks or 6 months?
Why is reprocessing 15% of the production?
Why did they bypass the formal approval step?
Why is the scrap bin full of rejected parts?

Profit Building Audits are not limited by the type of process. It can be stamping, running, fixing, securing, or storing, to name a few. It can be related to safety, quality, environmental, accounting, business and so on.

Reviewing the process flow and getting input from management will help you determine the data collection plan and sampling strategy. You will want to examine known or suspect weak areas of the system using directed sampling techniques. Problems cannot be fixed until a problem is identified. Many organizations have a suspect list of problems in their head or on paper, but there is not enough time to pursue an investigation to determine if a real problem exists. Auditors can work with the auditee to test suspect areas.

PREDICTING:
If audits can contribute to profit, can they also help build a future for the organization?

At first glance it may appear that audits are records of past performance and at best, report current conditions. But management has only minimal interest about yesterday, they are much more interested in what will happen tomorrow. In some cases the audit results can help fill that need. For example, based on the audit results, management may have a certain confidence level that the organization will continue to be compliant as long as the system controls remain, there are no significant changes, and sufficient resources are continually provided. If you are compliant today, it is likely that you will be compliant tomorrow (for a stable process). If you are making significant improvements today, it is likely that you will continue to make significant improvements tomorrow.

The confidence level in performance predictions decreases with time and when there are changes to the system. That is why audits need to be scheduled for areas where there has been management/ system changes or a significant amount of time has lapsed since the last audit. Audit results can be viewed as a leading indicator for continuous compliance, sustained effectiveness, or on-going performance improvement. Just as last month’s product quality report is a lagging indicator of the plants performance, it is also a leading indicator of product quality to be received by the customer. This is an important concept for you to remember and use. For example: The plant has recently experienced quality problems linked to the slow start up of the unit. Or do you report: The plant has recently experienced quality problems that are likely to cause increases in customer complaints and need for additional technical service resources. Reporting data representing leading indicators is more powerful.

An auditor may look at the past and present to forecast a future of prosperity or future business success or failure. An audit may also show no improvement or that there are problems such that there is a risk the company could lose it's license, or that it may not be able to pass a customer audit, or there are financial risks due to waste or quantity and quality of inventory. If things are bad, are they going to get worse or are they on the mend because the organization is moving in the right direction. There may be several problem areas but the issues are being addressed one by one because system controls exist to meet the challenges of the future. Management needs this additional assessment from auditors to make better decisions for building the organization.

BEST PRACTICES:

The third key to improving process performance is identification and implementation of best practices. It is proactive and it is the hardest to do well. There are known best practices that have proven themselves as benefiting the organization that we are too busy to implement. We are too busy with the daily status quo.

Best practices come in small and large packages. It can be technique for machine set up or an inventory control system. Best practices that could benefit many, should be reported. You may want to keep a separate log for best practices to show where they have been implemented. You will want to follow-up the implementation of best practices just like you follow-up the implementation of corrective action.

The final step is to bring it all together in a report that will be compelling and be read over and over again. People will want to get every morsel of information so that they can learn and better the organization.

PROFIT BUILDING AUDITS:

Competent auditors making observations today can 1) identify areas for improving profits, 2) use the data to forecast the future, and 3) share best practices with the organization. Observations should be linked to financial or to organizational goals of a non-financial nature such as creating a good work environment. Auditors of tomorrow will need to gain new knowledge and skills to provide value added services to their customers.

REFERENCES:

ISO 9000-2000
Russell and Regel, 1996 and 2000, *After the Quality Audit*
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