The Role of Audit in the Process of Optimizing the Management of Corporate Risk

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Abstract
Enterprises operating in conditions of uncertainty increasingly recognize the need to take action that will help to reduce the risk of worsening of the economic situation. The impact of such risks may be different, ranging from minor irregularities related to improper operation of selected controls to abuse and crime on a large scale. One of the factors potencialy reducing emerging risks is a properly functioning system of risk management. Its absence is indicated as one of the main causes of low efficiency of mechanisms detecting fraud in the organization as well as its incorrect functioning. Thus, given the growing scale of the problem in this area the knowledge of methods and tools protecting against emerging threats in modern organizations seems to be justified. The risk will always remain an issue burdened with uncertainty. However, a well-functioning system of risk management in the organization can contribute, to same extenet, to reduce this uncertainty. It should not only focus on selected aspects of the business, but on the entire corporation. The management of the company is responsible for proper functioning of the risk management process which cannot be static but must be flexible. To obtain this goal they can use various methods, techniques and tools, among which there is also the audit. Its main tasks is to evaluate the effectiveness of the risk management process and its continuous improvement. Hence, the purpose of this paper is to present the role and the importance of corporate risk and its management as well as to present the essence of action and application of audit in this area. The methodology used in the study is based on descriptive and comparative analysis related to the manifestation of the elements that shape the corporate risk management system in the organization and presentation of the audit's function and participation in this process by developing a model optimizing the corporate risk management.

Keywords: risk management, audit, control, management
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1. Introduction

Every country experiences cyclical economic collapses, which affect the condition of enterprises operating in the geographical area to bigger or smaller exent. However, often the causes of deterioration of the economic situation of the company should be seen not only in the external, but also the internal factors associated with poorly conducted business activity. This situation results in the wrong organization and business management, as well as the lack of oversight of an enterprise operations, or the occurrence of phenomena such as fraud and abuse (Moeller, 2011). Confirmation of this are the examples of famous scams recorded in years 2006-2010, which occured with the contribution of: Bernard Madoff (USA), Allen Stanford (USA), Jerome Karviel (France), Ramalingam Raju (India), Navin Shapiro (USA), Stein Bagger (Denmark). Appointed representatives of companies formed so-called pyramid schemes, which resulted in a giant finacial result demonstration, which was based on untrustworthy and unreliable financial data (Surdykowska, 2012). This was due to negligence in the management of the organization and the inefficiency of the functionin management system, which was unble to detect significant risks.

The results of the rsearch conducted by PricewaterhouseCoopers in 2008-2009 in 384 companies operating in Europe (PricewaterhouseCoopers, 2009) have indicated that despite the cultural differences, the managers make mistakes in the unit management, which in particularinclude (Dżurak, Biekionis):

- poorly organized system of communication and information flow,
- inefficient budgeting process,
- lack of measurement of key performance indicators,
- lack of regular measurement of liquidity and financial control,
- organizational barriers in the decision making process.

These mistakes costitute a significant risks to the organization. The reason of which may be improperly functioning system of risk management of the company. Inability to detect the risk of fundamental importance for the position and development of the company is currently becoming one of the most difficult problems of modern enterprises. This phenomenon is exacerbated by economic complexity, which contributes to the situation in which the managers in the decision making process are exposed to a wide range of information and data (Grudzewski, Hejduk, Sankowska, Wańtuchowicz, 2010), yet to make rational management decisions only theses that are relevant and appropriate are necessary. Managers who are able to use the available information and make the right selection, and thus to identify the most significant risks are able to react appropriately and protect their organization against the risk adverse effects.

With regard to the situation of the company on the market, as well as its economic position we are dealing with all kinds of threats that determine its functioning. These threats consitute corporate risk, which focuses on those elements, factors and conditions that determine the situation of the organization in different time horizons. Corporate risk is also referred to as the organization's risk and is associated with the corporate governance approved and operating in the organization. Corporate governance that is organized and functioning properly is a set of laws, rules and mechanisms governing the organization and meets the risk management issues. It should be noted, however, that the phenomenon associated with emerging threats to the organization is multi-dimensional, threfore the biggest problem in the corporate risk management is to find solutions, tools and mechanisms that will reduce the likelihood and consequences of the impact of such risks on the company's activity. Enterprise risk management is the process which constitutes an essential element of the management of the organization. This process should be organized and planned in such a way to provide management with reasonable assurance that the objectives of the organization are met. It can not be a fixed set of actions and activities, but must be flexible and constantly evolving, depending on the type and scale of emerging threats, as well as organizational and financial resources of the individual company. Risk management is a dynamic, multidirectional and interactive process in which almost every component can affect the other. It is not, and it should not be, implemented in the same way in different organizations. The needs and the abilities of the institutions to identify, evaluate and react to the risks vary considerably depending on the sector size, financial position, adopted management philosophy and culture of the organization. Therefore, it should correspond to the conditions in which the organization operates, and the use of specific tools and methods, and the division of responsibilities in this area should be properly adapted to these conditions (Spencer Pickett, 2005).

2. Literature review and used methodology

People and organizations, since time immemorial, have consciously tried to take various measures to prevent the occurrence of risks that could have a negative impact on them. However, the process associated with risk management on a large scale developed at the moment when big corporations appeared along with the various types of risks associated with their operation. Dynamic growth in risk management in recent decades is largely due to the activity of the banking sector. In 1974, the central bank governors of the ten developed countries decided to establish the Basel Committee for Banking Supervision (New Basel Capital Accord known as Basel II). Other important events in the development of risk management is the creation of the measurement standard of bank risk by Value at Risk (VaR) using RiskMetrics system by Bank JP Morgan in 1996. The next event is the development of the requirements for so-called solvency margin of insurance companies that were formally introduced in 2002 in the following directives: Solvency I then Solvency II. In addition to the above mentioned regulations in the field of risk management some other guidelines in this regard have been introduced. These are, in particular:

- Enterprise Risk Management model developed by the COSO called ERM II,
- Australian - New Zealand standard for risk management in 2004, AS / NZS 4360:2004,
- British standard for risk management - 2002, Management of Risk - A Strategic Overview, called the Orange Book, developed by three organizations: The Institute of Risk Management (IRM), The Association of Insurance and Risk Managers (AIRMIC) ALARM The National Forum for Risk Management in the Public Sector.

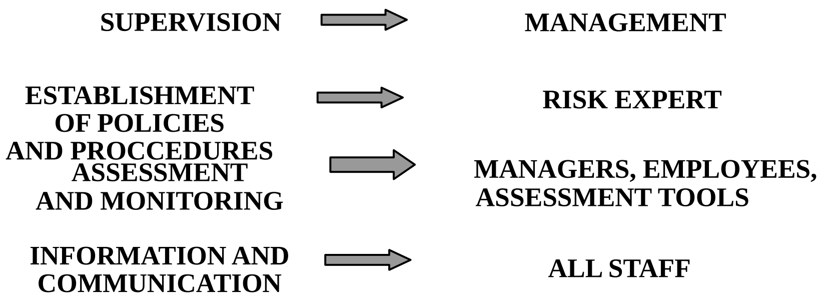
Risk management is a subject to which a lot of attention is devoted also in literature where corporate risk management and statistical methods of its management are presented. This paper doesn’t present any other method of dealing with risk, but describes one of the tools like audit which can contribute to this process operation improvement. English and Polish academic literature has presented so far audit development in various range, especially in United States (LB Sawyer, MA Dittenhofer, JH Scheiner 1996, MF Cangemi, T. Singleton 2003, LB Sawyer, MA Dittenhofer, JH Scheiner 1996, R. Moeller H. Witt 1999, MF Cangemi, T. Singleton 2003, KH Spencer Pickett 2004, Whitely J 2005, MA Dittenhofer, VP Filios 2007, John Bourn, Sir 2007) and in Poland (K. Wine 2007, K. Czerwinski, H. Grocholski 2003 Knedler K. Saunders , M. Stasiak, 2005, Saunders EJ 2002). Most of them describe audit ativities performance. In this paper the author has attempted to show the role of audit in the optimization of corporate risk management, and the scope of the audit function, taking into account the area of operation. The methodology used in his paper is principally based on descriptive analysis, the aim of which is to prepare the grounds for the author's own research related to the use of audit as a tool to support the process of corporate risk management in Polish organizations.

3. The area of corporate risk management and responsibility in this regard

In every organization there are many systems and processes in different fields and areas. The task of managers is the appropriate management and monitoring of these processes. If these measures are not taken, it means that the company is not properly managed, and thus remains out of control (Moeller, 2011). Risk management is a fundamental element of management. Hence, it should include all the elements of the organizational structure and its surroundings, i.e. systems, processes, people, internal and external environment. Risk management is an integral part of the decision-making process, and is the responsibility of the managers of the institution. Decision-making process should be accompanied by measures of the criterion of rationality. Often, it is dependent on factors beyond the control of decision-makers, such as political conditions and legal and financial constraints. However, there are also other aspects that determine the decision making process in the form of the features of managers, which in turn affect the acceptance of risk on a certain level which is so-called appetite for risk (Spencer Pickett, 2005), (COSO, 2004). All activities in the area of management should be correlated with the level of appetite for risk, if it doesn't occur in this way some actions need to be adjusted. The level of appetite for risk varies according to the situation in which the organization is, the conditions in which we manage risk and decision-making conditions that accompany this process.

Effectiveness of the risk management system is also dependent on the effectiveness of control mechanisms funtioning. They represent the actions and activities, such as regulation of the system, standards, procedures used in the organization as part of unit risk reduction. Each risk can be reduced by using more than one control mechanism. The control mechanism is adequate and effective if: meets designated mission in conformity with unit ethics, provides accurate and reliable data, is consistent with applicable law and the rules of the company, provides economical and efficient use of resources, ensures an adequate level of security assets. Enterprise management takes full responsibility for the implementation and operation of control mechanisms and thus, the accuracy and effectiveness of the risk management system functioning. Due to the fact that the risk is associated with the operation of the entire organization , and therefore applies to all the processes ocurring in it as well as the poeople involved, the company managers should also involve the staff of the institution in this process of corporate risk management. The division of responsibilities in the management of risk is shown in Figure 1.

Figure 1: The division of responsibilities in the management of corporate risk



Source: Authors' research

The Company's management is responsible for the oversight of corporate risk management, and is authorized take decisions in this regard. However, management may involve the other people in this procces like experts and advisors from within or outside the organization to create rules and procedures necessary to develop appropriate procedures. It should be noted, however, that due to the dynamism and diversity of the scale of emerging risks, it is hard to collect a fixed set of rules and actions applicable to risk management system. Regardless of the adopted solutions and ways to deal with the risk of the organization, the system should be continuously monitored by an appointed people and be evaluated by using various available independant tools. Note, however, that the effectiveness of this process depends on the quality and speed of information flow about the activities of each part of the company, so it should also involve the entire staff of the organization. Risk management is like an organ of the human body, if it is properly nurtured and controlled it works properly, but at any moment can surprise us. Managers of the organization should not rely on solid, proven principles and methods, but strive to improve the existing situation by evaluating the unit from the point of view of emerging risks. This process also requires continuous analysis, verification and improvement, and in this regard additional tools of support such as audit services may be helpful.

4. Audit as a tool optimizing risk

Audit is a support tool assisting management of the organization. Its purpose is to provide services for the assessment of the organization in the review of existing risks and improve its functioning by making recommendations to minimize occuring weaknesses. The role of the audit is to provide the managers with information on the accuracy and effectiveness of the organization's management system that is crucial in the decision making process. It focuses primarily on the identification of risk and the provision of information regarding the audited areas including the assessment of the activities for compliance with the objectives of the company to top management. It also provides an early warning system in order to avoid disturbances in the operation of the organization. Its purpose is to expose failures and shortcomings and errors, as well as showing the way of eliminating the consequences of these phenomena and hedging against their recurrence.

Use of the audit service is not always mandatory. There is a bunch of institutions in some countries that are required by law to use the audit (public sector entities, listed companies, banking institutions). There are aslo organizations functioning in the economy that are not obliged to use audit services and in such cases the decision whether to implement audit or not is taken by the management of the the organization. Hence, also the role of audit in the risk management process should be defined by senior executives. The opinion of the management on the role of audit in the risk management process can be infuenced by factors such as organizational culture, skills and abilities of employees and auditors, as well as local conditions or customs of the given country (see, IIA Standards, 2013). Audit can provide its services both by the external service provider or organizational unit operation within the company.

The role of the audit is to provide management information on the efficiency and effectiveness of the internal control system and risk management for all areas of the company's activity. Regardless of the form of services, audit covers all areas of operations, processes, systems and control mechanizms adopted in the enterprise, so it should focus on the accompanying risks taking into account both internal and external factors connected with the activities of the individual. Audit should focus on the most important aspects of the organization, representing the greatest risk and its range of activitiey should be broad and complex enough to allow the capture of weaknesses of the functioning management system. As mentioned , risk management is the responsibility of the management of the unit. Auditors can be only consultants or advisors in this regard, or may assist in identifying, assessing and selecting the approach to risk management by identifying ways to control , aimed at curbing emerging risks. Audit activity should assist the organization by identifying and evaluating the significant risks and contribute to the improvement of risk management systems. Its task is to monitor and evaluate the effectiveness of the risk management system of the institution (IIA Standards, 2013). The role of audit in relation to the process of risk management unit should be associated with:

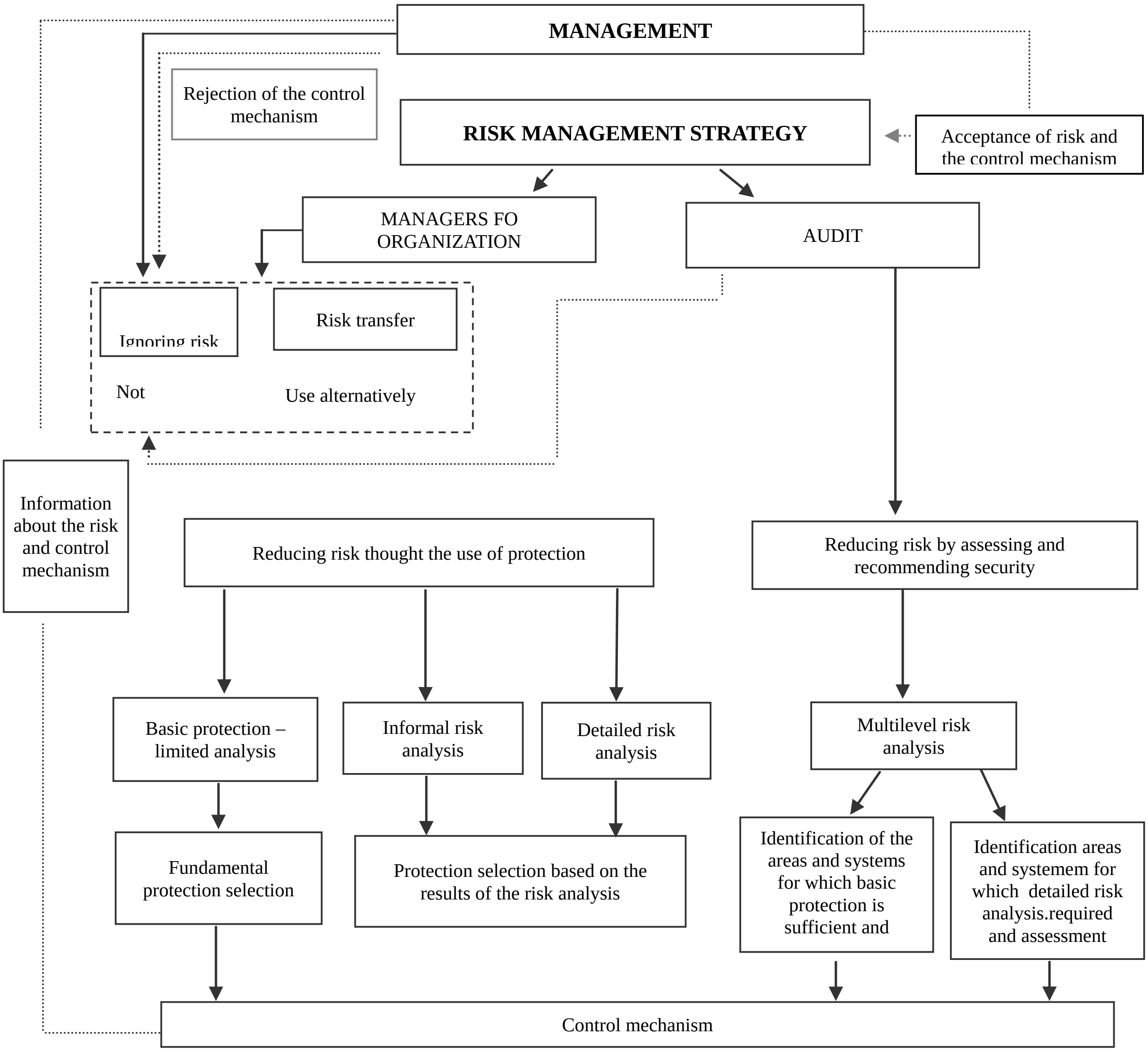
- evaluation of the risk management process as a part of audit services,
- active support and involvement in the risk management process through participation in committees, activities' supervising and monitoring as well as providing the management with the information on the state of these activities,
- submission of proposals improving the risk management process based on their findings and the analysis undertaken.

The audit should assess the level of corporate risk and its management at every level of organization. This risk can be verified by the auditor in terms of the area of the entity or comprehensively considering the entire system of management of the institution. The main task of the audit as part of the assessment process of corporate risk management is not only an analysis of its performance by reviewing existing control mechanisms, but the pursuit of its continuous improvement by proposing improvements in their effectiveness. In the corporate risk assessment, auditors may use different types of methods and guidelines. It should be noted, however, that the choice should be dictated by their comprehensive assessment of the situation of the company and the area it covers. Activities related to the provision of audit services, as well as the risk management process, are characterized by the fact that it has no fixed schema adopted and used assessment methods. They are flexible and can change depending on the type, size and extent of the risk, as well as specificity and the organization of a given area.

5. Model of optimization of the risk management process

The risk management system is an essential part of management of the organization, hence it must be integrated into it. The process of improving the functioning of the unit system of risk management and audit engagement in this field is presented in Figure 2.

Figure 2: Model of enhancement of the organization's risk management



Source: Author's research based on Białas, 2006

Risk management is associated with the risk management strategy approved by the board of an organization. The rest of the management is responsible for implementing this strategy. Additionally the board of organization may also appoint other tools for monitoring and controlling risks within the organization, for example in the form of an audit. The tasks of the organization's management and audit are slightly different in the frame of the adopted risk management system, but should be consistent with each other and strive to reduce both the impact and likelihood of occurrence of an event that will have a negative influence on the functioning of the unit.

Among the activities in the frame of the reduction of risk organization's management is obliged to:

- the use of appropriate protection such as basic protection,
- focusing on the areas of the highest risk,
- reviewing the functioning of all systems within the organization (Białas, 2006).

In turn, the task of the audit should not only be risk reduction but also improvement of the risk management system adopted in the unit. The audit shall asses areas that are specially vulnerable to risk or the ones that are of fundamental importance for the organization. For the above mentioned areas there should be created respective protections chosen on the basis of the risk analysis and with respect to the other areas of the organization functioning basic protection should be used. Any risk identified within the organization should not remain out of control. Regardless of the actions taken by the audit or the managers of the unit , the decision to adopt a certain control mechanism, thereby reducing the risk, should remain at the discretion of the Board.

It is not possible to identify all the risks that may arise in the organization, but you can try to minimize its impact and likelihood of occurrence. Considering the fact that proven processes, and enterprise risk management models do not exist, we cannot assume that the audit is the only reliable tool that is able to improve the process. However, the audit may support management in identifying and responding to emerging threats by taking verifying and monitoring actions. The involvement of the audit should take place primarily on the entity's operation areas and the results of its assessment should be transfered to management decisions and policies formulated in the company in other words to the strategic level of the organization.

6. Conclusions

Enterprises operate under constantly changing environment which results in the situation that every organization is prone to mistakes, which sometimes cannot be avoided. Acting in the face of uncertainty, these institutions must respond quickly and efficiently to changes in their internal and external environment. In this case, risk management becomes necessary in the decision-making process. The risk is a phenomenon faced by all companies, without exception. Therefore if the individual units want to survive they have to respond to it properly. That is why the organizations should be controlled in terms of efficiency and effectiveness of their operations. In a market economy, there are many mechanisms to exercise control over the activities of the organization, both from external and internal point of view. Organization's activity is supervised externally by the capital market, products and services, or labour market while internal supervision is carried by the board of the unit (Herdan, Stuss, Krasodomska, 2009). Ignoring and belittling changes may result in a decrease of the positon and value of the company. One possible solution to protect your organization against emerging risks can be the use of appropriate control mechanisms by the management and continuous evaluation of the effectiveness of their actions. The audit may be a useful tool for monitoring, evaluating and improving the effectiveness of the risk management system of the organization. At the same time, it allows the company continuous development by recommending changes. The paper presents a model of optimization of risk management through the use of a tool such as audit. It also provides a theoretical background for further work of undertaking the author 's own research to evaluate the use of an audit which can be a tool in the improvement of the management of corporate risk in organizations.

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