

## **Internal Audit of Compensations and Benefits: Tasks and Risks in Production Systems**

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*Compensations and benefits have always been very sensitive and complex activity of HRM process in production systems. Model of compensations presents financial and non-financial rewards linked to efforts and performances of employees and executives. Since this activity is understood as very important due to two main reasons, that compensations are motivation factor for employees and operational costs are for the company, there is a demand of making rewarding process highly effective and efficient for reaching employees and shareholders satisfaction. Besides this, many frauds, risks and problems related to amounts of executive compensations in the past initiate the need of appropriate management and control of this process. One possible way of reaching the effectiveness and efficiency of compensation process in terms of appropriate governance, risk management and control is the internal audit. Internal audit can be defined as method of independent and objective validation that increases the value and improves the operation and performance of organization and also facilitates the effects of related processes to achieve organization's goals and objectives. The main objective of this paper was to explore the reasons for, the processes involved in and risks of internal audit in HRM area of compensation and benefits. In the paper a desk research method has been used. First, the authors made a review of literature available on internal audit, with significant analysis of internal audit standards. In continuation, the rewarding process and compensations and benefits structure has been analyzed according to the practices of organizations systems and literature of HRM. After theoretical analysis, the authors integrated appropriate aspects and steps of internal audit in compensation process, where they emphasized the role of internal audit in compensation and benefit structures and amount of compensation's expenditures (related to the executive compensations).*

*Findings of this paper are that the main reason for implementing internal audit through planned system of steps (gathering information, evaluation, analysis and action planning) and approaches (mainly by surveys) is to obtain information that would be helpful for the organization as a whole in terms of improvement of business processes related to compensation and benefit. Also, internal audit of compensation and benefit package can minimize risks that are linked to HR compensation process (employment market risk, reputation risk, compliance risk, external partnership risk, operation risk, financial reporting risk, etc.) where reputation risk is one of the most common reasons for performing internal audit. Areas where internal audit can be done are human resources strategic management, workforce planning and selection; training and development; compensation and benefit system; employee and labor relations; human resources information systems, etc. As the most important areas of HR compensation internal audit there are emphasized overall plan design, cash and stock-based compensation, deferred compensation and pension and retirement contributions.*

*The paper presented one theoretical research made to point out the role of internal audit in HR compensation process. Previous researches related to this topic usually were made to analyze the relation between internal audit and several or even all HR functions. Authors tried to develop a comprehensive model for internal audit of compensations and benefits. Also, the paper described both, internal audit and rewarding processes which were integrated in function of better management in terms of effectiveness and efficiency.*

**Keywords:** human resource management, internal audit, compensations, benefits, risk.

## Introduction

Human Resource Management (HRM) as a concept of managing the major resource of contemporary organizations, people, includes certain functions such as planning, staffing (recruitment, selection and orientation), training, development and career development, performance measurement, compensation and benefits, leaving the organizations and the like. With adequate structuring of HRM organizations can provide significant improvements in business in terms of higher performance and in particular, the competitive advantage of organizations (Wall & Wood, 2005; Collins & Clark, 2003; Wright *et al.*, 1994). Employees with their knowledge, expertise, motivation, loyalty and dedication to the company essentially determine the performances and market position of a company; they have the ability to create other forms of intellectual capital that will have a growing strategic importance for the company in long run. Only, when mentioning performances, we have to be careful since over the past 20 years there has been a considerable expansion in theory and research about human resource management and performance, but researchers are still unable to answer core questions about the relationship between these variables (Guest, 2011).

If the activities of HRM are taken into consideration, especially interesting field is a system of compensation and benefits. Compensations are seen as a mechanism of development and intensification of the global corporate culture, the primary source of corporate control, which very explicitly associate achieved performance with the incurred costs and the link between all the sharper, sophisticated public discourses about central issues related to corporate governance in international contexts (Dowling *et al.*, 2008) especially if we are talking about executive compensations. Besides the fact that compensations are of the most important part of HRM for employees and executives as financial reward for job done, this area is also one of the most complicated in terms of production system management. Compensations are direct financial costs for the organization, and if the fact is taken that labor costs may represent a great amount of total operating costs, there is a need of viewing the compensation system in terms of investments that will result in value added.

Because of the complexity of compensation process in HRM it is significant to explore possibilities of improving this process in terms of efficiency and effectiveness. We find internal audit as the possibility for solving and improving HR processes in production systems. Auditing HRM by considering HR outcomes (*e.g.* turnover and absenteeism) is not difficult, but linking HRM to overall organizational performance is more contentious, although there is a growing literature (Guest 1997). Audit in HRM has been analyzed in scientific researches since it is recognized to bring value, transparency to the working processes and generally help management in organizations (Shaban 2012; Mihret, Yismaw 2007; Verreault, Hyland 2005; Gupta 2004; Hyland, Verreault 2003; Bargerstock, 2000; Hendry *et al.*, 2000; Florkowski, Schuler 1994; Bach 1994). Namely, internal audit can bring transparency to compensation and ensure that the process established in aligning and developing compensation packages has

credibility and it is made in accordance with the law, internal regulations and the needs of the production system.

The main objective of this paper was to explore the reasons for, the processes involved in, and risks of internal audit in HR area of compensation and benefits. In the paper a desk research method has been used. First, the authors made a review of literature available on internal audit, with significant analysis of internal audit standards. In continuation, the rewarding process and compensations and benefits structure has been analyzed according to the practices of organizations systems and literature of HRM. After theoretical analysis, the authors integrated appropriate aspects and steps of internal audit in compensation process, where they emphasized the role of internal audit in compensation and benefit structures and amount of compensation's expenditures (related to the executive compensations). There have been emphasized the reasons for internal audit implementation, the processes involved in, and described the main risks of internal audit in HR rewarding process.

The paper presents one theoretical research made to point out the role of internal audit in compensation process. Previous researches related to this topic usually were made to analyze the relation between internal audit and several or even all HR functions. The authors tried to develop a comprehensive model for internal audit of compensations and benefits. Also, the paper described both, internal audit and rewarding processes which were integrated in function of better management in terms of effectiveness and efficiency. It also bridges a gap between the HRM and the internal auditing literature.

## Internal audit and reasons for implementation in HRM compensation process

Financial statements, accounting and auditing provide relevant information on the financial position and performance of company's business. The need for improved financial reporting, accounting and auditing is a general trend in all financial systems. This is caused by the emergence of the financial crisis and the crisis in corporate governance (Sabovic *et al.*, 2010). Responsibility for corporate governance lies on several organizational entities. Main participants in corporate governance are board, executive management, internal auditor and external auditor (Beke-Trivunac, 2011). Based on the analysis of resource and competence based strategic management theories, four groups of factors that take part in audit business organization's value creation could be determined as characteristics of audit business services, internal resources, strategic opportunities and competencies. Those groups of factors interacting with each other are able to ensure value creation in audit business organization and achievement of strategic goals (Gimzauskiene & Staliuniene, 2010). Especially interesting area of auditing is internal audit, which has a main task to be support for the management of the company.

According to The Institute of Internal Auditors (IIA) internal auditing is defined as an independent, objective assurance and consulting activity designed to add value and improve organization's operations. It helps the organization accomplish its objectives by bringing

systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (<http://www.theiia.org>). One more comprehensive definition of internal audit defines it as multi – step process aimed at determining whether existing processes and procedures (condition) comply with predetermined rules and regulations (the criteria) or deviate in any way from this standard (Kagermann *et al.*, 2008) or as a method of independent and objective validation, it not only increases the value and improves the operation and performance of the organization, but also facilitates the effects of related processes to achieve the organization's goals (Kanellou & Spathis, 2011). Internal audit examines the organization and functioning of accounting systems and related internal controls, credibility of financial and operational information, it evaluates the economy, efficiency and effectiveness of business operations and control, application of policies, plans and procedures and conducts special checks. Unlike the audit of financial statements that is focused on testing and assessment of the reality and objectivity of financial reports and that is traditionally done by external auditors, internal audit has focused on testing and assessment of business and developing and increasing the success of the organization as a whole (Tusek & Sever, 2007). The profession of auditing is a rich resource for enterprises because the audit activity monitors the adequacy and effectiveness of management's control framework and contributes to the integrity of corporate governance, risk evaluation, and financial, operating and IT systems (Burnaby & Hass, 2009).

From the cited definitions of internal audit it can be concluded that there are three most important parts of this process: corporate governance, risk management and control. To make sure to keep the basic objectives and responsibilities of internal auditor and the whole process of auditing, IIA has developed *International Standards for the Professional Practice of Internal Auditing (Standards)* for each part of internal audit process. As the most important concepts that make a framework for internal audit, in this paper there were explained standards related to *corporate governance, risk management and control*.

*Standard 2110 – Governance* implies that the internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization;
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

*Standard 2120 – Risk Management* considers many facts about evaluation of the effectiveness and contribution to the improvement of risk management processes. The attention of contemporary internal audit is more diverted to risk management, which allows it to take important role in company management and add value to the organization. The internal audit activity must evaluate risk exposures

regarding the:

- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations and programs;
- Safeguarding of assets;
- Compliance with laws, regulations, policies, procedures, and contracts.

*Standard 2130 – Control* suggests that internal auditors must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations, and information systems. Internal auditors must incorporate knowledge of controls and risks gained from consulting engagements into their evaluation of the organization's control and risk management processes.

According to General and Specific Standards for the Professional Practice of Internal Auditing, issued by the IIA in 1978, and *Performance Standards* of the IIA, process of internal audit should include (European Confederation of Institutes of Internal Auditing 1996; Pickett, 2003):

- Planning the audit (Engagement Planning) - internal auditors should plan each audit;
- Examining and evaluating information (Performing the Engagement) - internal auditors should collect, analyze, interpret, and document information to support audit results;
- Communicating results - internal auditors should report the results of their audit work;
- Following up (Monitoring Progress) - internal auditors should follow up to ascertain that appropriate action is taken on reported audit findings.

As it is presented, internal audit can be understood as a support for corporate managers. Namely, internal audits allow managers of larger production systems to delegate its oversights function to internal audit department. This is important because of several reasons (Kagermann *et al.*, 2008):

- Growing complexity of the operating environment due to automated data processing;
- Increased decentralization in physical location and decision making as a result of globalization or internalization;
- Its lack of expertise required to conduct efficient, high – quality audits.

After analyzing definition and some of the standards of internal audit it can be concluded that this process can improve effectiveness and efficiency, and by that, the performances of many functions in one production system. One of the most important function and process in contemporary companies is HRM function. Why “*one of the most important*” it can be seen from the view of Cosic and Tesic (2009) who claimed that the basis for the development of company are human resources that have independent thinking, are likely to reflective effect, they have aspirations beyond their possibilities, have the courage for action, not afraid of possible mistakes, able to act between the established and innovative prediction of uncertainty and which operate between the known and unknown. HRM as a concept of managing the major resource of contemporary organizations, people, includes certain functions such as planning, staffing, training, development and career development, performance

management, compensation and benefits, leaving the organizations and the like. As a strategic part and process in the company, HR function can be a subject of audit. Namely, HR auditing is an extension of traditional auditing, which until recent years was limited to the financial practices of the organization. HR audit is an overall quality control check on HR activities in a division or company and an evaluation of how these activities support the organization's strategy (Shaban, 2012).

There has been a tremendous expansion in the extent, scope, and types of information being audited. In addition to human resources, auditing has now moved into production, operations, sales, quality, data processing, and engineering. It has become a critical analytical tool to assess how well-or how poorly-an activity is performed. HR auditing provides the necessary baseline data so that actions can be taken to improve HR performance (Phillips, 1999). The scope of the HR audit is increasing and it can include department mission, staffing, training and development, benefits, labor relations, compensation, human resources planning, etc.

In terms of HR audit, Poloski Vokic and Vidovic in 2008 evaluated the quality of human resource management in Croatia since the excellent human resource policies, programs and activities enable enterprises to maximize workforce productivity. This research was conducted in enterprises with more than 200 employees and the value of HRM was assessed using the HR audit approach. Also, it is important here to mention the research made by Cannings and Hills (2012) where they reviewed traditional and existing common approaches, identified the shortcomings of these, and proposed a new framework for HR auditing based on business contribution.

On the other hand, Bargerstock gave also a framework for HR audit, where he emphasized that the audit unfolds through four phases:

- Ranking Importance of the HRM Service Portfolio;
- HRM Team Self-Evaluation;
- Measuring Current Service Levels;
- Developing Action Plans (Bargerstock, 2000).

After presenting the internal audit in HRM, for further analysis it is important to give an explanation of compensation process. Namely, from all activities coordinated by HRM function, compensation and benefit management is definitively one of the most complex processes. The complexity of compensation and benefit process can be explained in next terms.

First, compensations are *operational costs for the company*, making up to 60 % of total operational costs of the company (Stangl *et al.*, 2009) and they have to be understood as investments in human capital, and the costs can be direct costs of the benefits, or incremental costs, such as administration (Morley & Czarnecki, 2010). Understood in this way, costs of compensations have to be properly managed. Second, compensations and benefits are mechanism of corporate culture and make one of the most important *motivation factors for many executives and employees*. Motivation and performances are shaped based on the link between the effort and the reward and by the importance or valence of the reward to the person in question (Brewster *et al.*, 2007).

Third, according to Gupta (2004) *executives* have accumulated *enormous wealth* that has little or even *negative correlation with their contribution to the long-term performance* of their companies. Executives have received generous pay after periods of undistinguished or failing performances.

Fourth, since compensations and benefits are material and nonmaterial rewards for employees and executives, they can be a subject for many *risks* and also financial rewards can be a subject for many frauds.

Because of the complexity of compensation process in HRM, given trough several reasons above, it is significant to explore possibilities of improving compensation's process by providing insight and recommendations based on analyses and assessments of available data. This can be done through internal audit. Compensation audit can bring transparency to executive compensation disclosures and ensure that the process established in aligning and developing compensation packages has credibility and integrity by enlisting internal auditing to conduct executive compensation audits (Gupta, 2004). This is the main reason for making internal auditing in compensation and benefits. Beside this, one more reason why internal audit is very significant process for efficiency of production system is the fact that management of the company often is in the position of designing and recommending its own compensation. Amounts and structure of rewards can be highly inconsistent with the production system's performances, so internal auditors can inspect and control adequacy of the set rewarding system in the company.

Some researches, done in the past, can also explain the reasons for internal audit and its importance in HRM. One very interesting research (Hyland & Verreault, 2003) was made in USA to investigate the relationship between HR department and internal audit. In that paper authors presented a model for analyzing the potential for value creation of the internal audit function, the human resource management function, and the internal audit and HRM pairing. A survey of 161 chief audit executives indicated that virtually all internal audit functions are *risk managing* in their audit approaches, while a great majority of HRM clients are also moderately or strongly *strategic* in their outlook. Findings included that a productive working relationship was strongest when a risk managing internal audit function is paired with a strategic HRM function. Also, the internal audit planning process was found to be more strategic in the presence of the same pairing (Hyland & Verreault, 2003). Similar analysis related to risk management was made by the same authors, Verreault and Hyland, in 2005. Studies on competitive environment of firms, theoretical development in HRM, empirical work on the link between HRM practice and firm performance, and emerging models based on intellectual capital, suggested that there are compelling reasons for internal audit to devote substantial resources to the evaluation of strategic risk in HRM audits.

Also, a significant influence was made in this area with the research of Florkowski and Schuler in 1994. They investigated how MNEs enhance their ability to utilize human resources and internal labor markets for competitive advantage through audits of the international

human resource management (IHRM) function (Florkowski & Schuler, 1994). They emphasized the importance of proper management and internal audit of international business and human resources in function of competitive advantages and the success of the MNE. Another research, made in 2011 in Iran, was related to the influence of the cultural factors effect on auditors' assessment estimation of internal control and control risk determination. The results showed that certified accountants observed that collectivism control risk is higher than individualism. Cultural factors such as anxiety and stress on organization employees relative to future unclear situation, reliance to technology, religious and rules, individual's tendency to bold behavior, superiority, championship, humility and care of weak people have no effect on corporations control structure measurement and control risk determination (Moradi *et al.*, 2011). Research of Moradi, Salehi and Fakharabadi in 2011 was important since the auditors, internal and external, should be objective and independent in the implementation of audits, and many cultural aspects, or dimension, can make influences on auditors' assessments.

On the other hand, Hendry, Woodward, Bradley, Perkins 2000 tried to introduce a model for planning and thinking about performances and rewards. This was an attempt to clarify what performance should be talking about, how and whether it is measurable and how performance is best improved, before the HR specialist is called on to redesign an organization's reward system. Related to the topic of compensations and rewards, foreign authors developed a multi-theoretic approach, drawing on economic, institutional, managerial power and social comparison literatures to explain the role of the external compensation consultant in the top management pay setting institutional field in UK. Namely, they showed that consultants are prevalent part of the executive pay setting scene, and document evidence of all advisor use (Conyon *et al.*, 2011). This was one more attempt for improving reward system.

As it can be viewed, there are many reasons for doing internal audit in area of HR compensations and benefits. Also, there are some researches done in the past that promote interest in, and indicate the importance and benefits of internal audit in contemporary production system. The request for cost efficiency, in terms of expenditures, and the effectiveness, in terms of corporate governance, high performances and above – average profits are typical for modern companies. All those requirements are also related to HRM process, and inside of it, compensations for employees. Beside the reasons and importance, it is significant to analyze tasks, areas and risks that are linked to compensation internal audit.

### **Compensation and benefit structure and internal audit tasks involved**

HRM procedures and policies in the company are very important for two reasons. First, they present expected level of employees' behaving and standards for functioning of HR activities in the company. Savaneviciene and Stankeviciute (2010) emphasized work of Boselie, Dietz and Boon in 2005 where these authors identified 26

different practices that can be seen to reflect the main objectives of the majority of strategic HRM programs used in different 104 studies, of which the top four are, in order of popularity: training and development, contingent pay and reward schemes, performance management (including appraisal), and careful recruitment and selection. Second, those policies are standards that should be fulfilled and bases on which internal control and internal audit will be done. Areas where these human resources policies and practices are particularly important include (Moeller, 2009): recruitment and hiring; new employee orientation; evaluation, promotion and *compensation*; disciplinary actions.

Rewards are a complex system that affects motivation and satisfaction of employees in the organization, but also the functioning of the production system in terms of operating expenses. It is necessary to examine the processes of compensation and benefit, the main stages of it and structure of rewarding system. The basic stages of compensation process can be described as (Berber *et al.*, 2011):

*Job analysis* is the process of collecting relevant information on jobs and specifying the knowledge, abilities, skills and other requirements necessary to perform a specific job;

*Evaluation of job* consists of requirements what the worker should do, determining the importance of work for organization and job classification according to their relevance;

*Determining the structure of compensations and benefits* – basic components of compensation packet can be structured from many different elements. If we take into consideration also the compensations of expatriates, elements from table 1 can be calculated in the structure of company compensation package (Stangl *et al.*, 2005; Dowling *et al.*, 2008; Briscoe *et al.*, 2009; Morley & Czarnecki, 2010).

Table 1

## Types and elements of compensation package

COMPENSATIONS	BENEFITS
<i>Base salary</i> – minimum wage for performing a certain job in a company	<i>Athletic or Cultural Facilities Seats</i> – purchase or seats or facilities in sports arenas, etc.
<i>Foreign Service inducement/hardship premium</i> – paid by parent country as means of inducement for taking the work task abroad	<i>Athletic, Cultural, Dining and Travel Club Memberships</i> – Reimbursing or paying directly for employee memberships
<i>Allowances</i> – fixed payments paid periodically to reasonably approximate the employee's costs for a particular type of expense: <i>cost of living allowances (COLA), habitation allowance, home leave allowance, education allowance, relocation allowances, spouse assistance, clothing allowances, etc.</i>	<i>Financial and Retirement Planning</i> – service that assists the employee in creating and managing personal budget
<i>Awards</i> – similar to bonus; often paid for individual goals or for unexpected or extraordinary performance; it can be a fixed amount, or a percentage of salary	<i>Gifts</i> – currency, shares, property, or services
<i>Premia</i> – paid to employees who work in unusual time (at night or on holidays)	<i>Health insurance</i> – payment in percentage of gross salary each month; determined by law and collective bargaining (for example, in Serbia, this percentage is 6,15%)
<i>Overtime</i> – If the employee works more than full – time usually gets 10 to 50% greater schedule	<i>Pension insurance</i> – similar to Retirement planning; fixed percentage of gross salary paid monthly (for example, in Serbia, this percentage is 11%)
<i>Incentive</i> – determined depending on the individual or group performance	<i>Unemployment insurance</i> – payment for case of unemployment. It is paid in percentage of gross salary (for example, in Serbia, this percentage is 0,75%)
<i>Bonus</i> – separated from the employee output; it depends on the success of the company and is not regulated by the work contract. Christmas and New Year bonuses fit in this group, as well as the profits distribution and various kinds of shareholding. Bonuses may be structured for short or long – term performance of the organization, department or individual	<i>Insurance</i> – payment for all or portion of premiums for life insurance, car insurance, dental care, home insurance, etc.
<i>Commission</i> – pre-established remuneration paid for achieving specific volume of sales or a market service goal	<i>Security Services</i> – provided as a result of threat assessments and risk management programs
<i>Severance</i> – remuneration made to an employee upon termination from the organization. They can take the form of a lump sum payment or may be paid out over a specific period. Severance can be paid in fixed amount or in a percentage of salary.	<i>Loans</i> – No or low-interest loans to employee for many different purposes
<i>Perquisites</i> – benefits offered at the employer's discretion, rather than benefits required by law; company cars or car allowances, parking, airlines lounge membership, etc.	<i>Saving and investments</i> – administer employee savings
	<i>Outplacement</i> – service provided for assisting terminated employee for finding new employment
	<i>Taxes</i> – fixed payment in percentage of gross salary; can be paid the government directly, by reimbursing the employees or by increasing bonus to cover costs of taxes

In determining the salary structure important factors that affect this activity are state of the labor market, labor law, the impact of collective bargaining and unions, and attitudes of managers and financial solvency of companies.

*Performance measurement* is an assessment of current or previous results of performance of the employee. Labor standards should be defined together with the employees in accordance with the objectives of the organization. Based on these established results, apart from defining the basic pay, management acquire the possibility of additional compensation for employees by developing a system of benefits. In performance management it is necessary to bear in mind modern system of determining wages – *pay for performance* (Stangl-Susnjar & Lekovic, 2009; Dowling *et al.*, 2008; Briscoe *et al.*, 2009);

*Implementation of payment systems, feedback and monitoring* includes all activities so that employee can achieve individual compensation and to obtain information on whether an individual is satisfied.

Internal audit in HR compensations and benefits can be understood as the process aimed at determining whether existing processes and procedures of rewarding employees and executives comply with predetermined rules and

regulations made according to laws and statute of the company and adopted by committee, or deviate in any way from it. When comes to performing internal audit in employee and executive compensation, audit can focus on one or all of four *key dimensions* (Gupta, 2004):

- compensation committee philosophy and structure;
- compensation consultants' role and performance;
- executive pay and perks;
- executive compensation – related disclosures in the proxy filings.

On the other hand, according to Wheeler (1994), wages can be audit from several dimensions, presented in table 2. This table does not represent mandatory areas for audit, but those that may be interesting for company and internal auditors.

A variety of methods can be used to conduct audits including interviews, surveys, observations, or a combination of these. The survey is the most preferred approach (Phillips, 1999). McConnell in his book *Auditing Your Human Resources Department* (2011) used it in his “four steps” for each area of HRM.

Comprehensive look at internal audit of compensations and benefits authors of this paper have presented in *figure*

Table 2

Areas and of compensations and benefits and tasks for internal audit

1. Record Making – Recordkeeping	Time records; Payroll records; Collective bargaining agreements, contracts; Training wage; Notice posting
2. Minimum wage	State of local law; Training wage requirements; Deductions; Reporting, call-In, on-call; Training
3. Overtime Work	Record of hours worked; Salaried employees; Exempt employees; State or local law; Time not worked; Scheduling, notice; Required overtime; Incentive pay; "Comp" time
4. Equal Pay/Non-Discrimination Issues	Segregated job categories; Pay differentials for women, minorities; Documentation for basis for differentials
5. Required Deductions/Withholding	Federal, state and local income tax withholding and forms; Unemployment taxes; Independent contractors; Leased/temporary employees
6. Other Deductions	State or local law; Policies authorizing deductions; Authorization forms
7. Employee Appraisals	Defined criteria; Consistency; Documentation; Minimize subjectivity; Record retention requirements
8. Vacations, Holidays, Personal Leave, Sick Leave, other Leaves	Accurate and complete description; Qualification; Accumulation/vesting; Scheduling/work on holiday; Conditions; Forfeiture of pay; Carry-over; Level of compensation; Mandated leave
9. Leaves of Absence/Disability	Clear description; Non-Discrimination; Interaction with paid leave, worker's compensation; Treatment of benefits; Veteran's, Reservists Rights
10. Insurance Benefits	Clear description; Consistency of all descriptions; Qualification; Flexibility to alter or eliminate program; Compliance with state and local law; Competent administration; Minimization of employer liability; Employee obligations; Coordination of benefits; Clear definition of when benefits terminate; Multi-employer plans
11. Pension Benefits & Deferred Compensation	Qualified vs. Non-Qualified; Tax consequences; Multi-employer plans; Area for expert consultation only

Source: Wheeler, S. (1994) *Human Resource Audit*, p. 35 – 37; in Gould, W. A. (1994) *Human Resource Development for the Food Industries*.

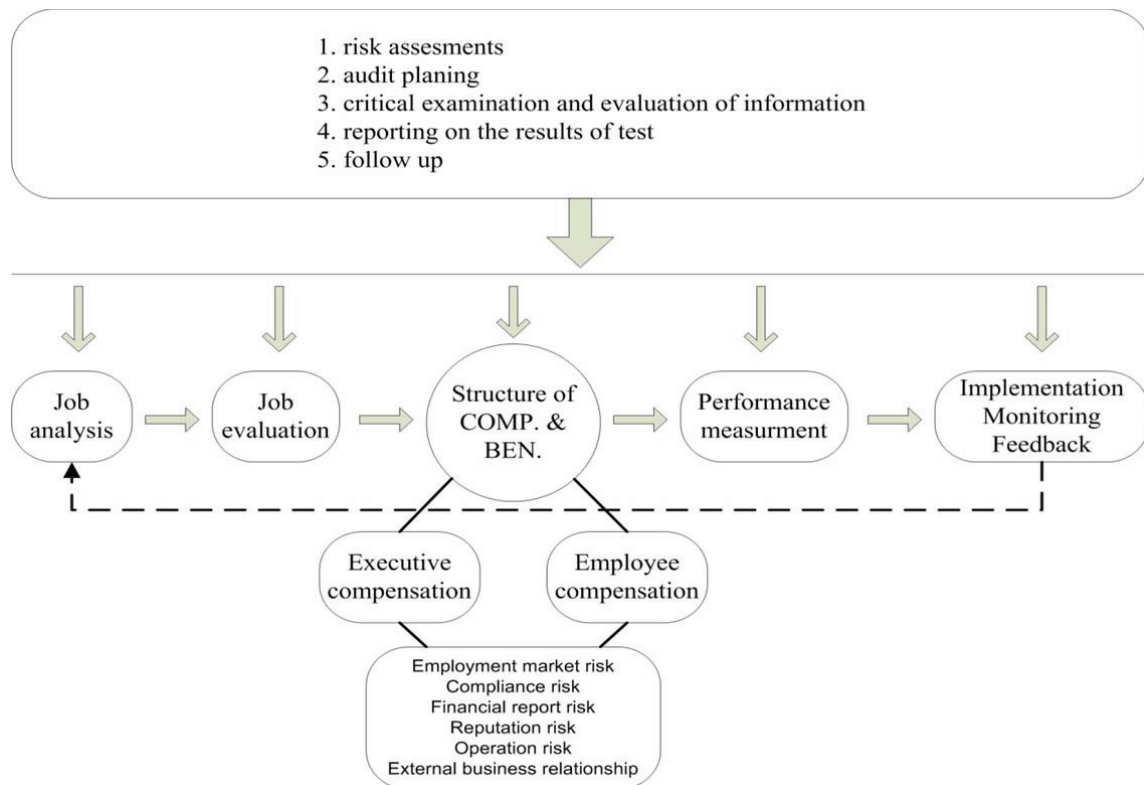


Figure 1. Internal audit of compensations and benefits

**Risk in internal audit of compensation and benefit**

Internal audit of compensations and benefits also exposes organization to several risks. Some of them are (Morley & Czarnecki, 2010):

Employment market risk – every compensation package should be competitive in the employment market,

so that company will be interesting for individuals who are qualified for organizations. If this requirement is not satisfied, the organization may fail in attracting and retaining talents.

Compliance risk – organization has to comply with the law and regulations.

Financial reporting risk – there can be misclassification of operational and financial data, poor accounting, disclosure control, etc.

Reputation risk – Morale and ethic issues related compensations and benefits management. Reputation risk is cited most often among organizations in the research made in 2010. It estimates 41.9 % as the reason for conducting such internal audit in executive compensation and benefit (<http://www.theiia.org>).

Operating risk – errors or frauds in designing the compensations package, bad governance processes and internal controls, inadequate feedback and oversight, fail in optimizing costs, behavior that is inconsistent with the interests of relevant stakeholders.

External business relationships – fail related to outsourced services providers.

Main problems and complexities came from the area of executive compensation and benefit. The global survey made in 2010 in USA by IIA reveals that only 45.3 % of respondent organizations conduct even limited reviews of the appropriateness of executive compensation and benefit, and that only about one-third of such reviews are spearheaded by internal auditing. The top five focused areas of internal audit of HR executive compensation and benefit are (<http://www.theiia.org>): overall plan design (56 %), cash compensation (56 %), stock-based compensation (37.4 %), deferred compensation (31.9 %) and pension and other retirement contributions (25.3 %).

Approaches, tools and techniques for managing risk are numerous. They can be presented as quantitative and qualitative. In the paper there are mentioned some well known and often used approaches.

For example, risk maps, usually those that measure two variables: on the vertical axis variable is a probably given risk occurring (probability) and on the horizontal axis it is presented the impact that the risk will have on the project or program (impact), help the organization to identify and assess its risks. Other techniques include:

- Questionnaires;
- Surveys;
- Self-assessment;
- Risk scans;
- Assessment templates and the like.

The communication technologies such as internet and intranet also can be increasingly used to promote risk awareness, obtain information on risk in specific areas, communicate with employees, share information on risk management across agencies and communicate risk management objectives (<http://www.tbs-sct.gc.ca>).

On the other hand, several quantitative methods are in use in risk management internal audit. Friedlob and Schleifer described different types of uncertainty and a relatively new method of dealing with uncertainty referred to as fuzzy logic. This complex approach has “contributed greatly to the development of artificial intelligence and has the potential to facilitate internal auditors’ measurement and management of risk and uncertainty in the audit environment” (1999). Also, some statistical tools are in practice. One of them is the statistical compensation analysis with multiple-regression analysis. This technique consists of seven stages and it is used to help organizations

evaluate their compensation practices for signs of pay inequalities (<http://www.biddle.com>).

For the conclusion related to risk management it can be said that internal audits that would promote transparency in executive compensation disclosures would inevitably work to raise the market's trust and confidence in a company, which in turn leads the capital providers to ask for a lesser risk premium to own the stock or debt of such a company. This reduction in the cost of capital works directly to enhance shareholder value (Gupta, 2004). By decreasing all risks to minimum, a company can achieve many benefits beside financial (better reputation, satisfaction of employees, trust of shareholders, satisfaction of outsourced services, etc.).

## Conclusions

According to many authors, researches and international societies, internal audit can be used for improving compensation's process in terms of efficiency and effectiveness, by providing insight and recommendations based on analyses and assessments of available data from the company. Rewarding system is very complex structure of activities and many different kinds of compensation and benefit types, it demands adequate management and control, and presents one of the most important function in the company since it is directly linked to employees, the only creative resource in organization. Viewed as costs for the company (shareholders) and rewards and motivation factor for employees, compensation and benefit process brings many complexities which can be overcome with the implementation of internal audit.

As main contributions and conclusions of this research there can be emphasized next:

- Internal audit is a support to HR management and corporate governance. Main *reason* for implementing internal audit through planned system of steps (gathering information, evaluation, analysis and action planning) and approaches (mainly by surveys) is to obtain information that would be helpful for the organization as a whole in terms of improvement of business processes related to compensation and benefit (job analysis, evaluation of job, structure of compensations and benefits, performance management and implementation and monitoring).

- Internal audit of compensation and benefit package can minimize *risks* that are linked to HR compensation process (employment market risk, reputation risk, compliance risk, external partnership risk, operation risk, financial reporting risk, etc.). Reputation risk is one of the most common reasons for performing internal audit. By minimizing risks, company's management can achieve many benefits, where satisfaction of employees and shareholders is one of the most important. Several techniques and tools are in practice when the risk management is in question. Surveys, questionnaires, qualitative and quantitative methods are commonly used.

- Areas where internal audit can be done are human resources strategic management, workforce planning and selection; training and development; compensation and benefit system; employee and labor relations; human resources information systems, etc. Main *areas* of HR



compensation internal audit are overall plan design, cash and stock-based compensation, deferred compensation and pension and retirement contributions.

- Especially interesting area of HR compensation internal audit is *executive compensation* and benefit programs. These programs are structured for rewarding executives, people that are responsible for managing company's business processes, functions and company as a

whole. Executives' compensations and benefits can have little or even negative correlation with their contribution to the long-term performance of their companies. Internal audit can promote transparency in executive compensation and point out the elements which are in contrary to amount of executive reward and their real outcome and performances. This will also influence a raise of the market's trust and confidence in a company.

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**Kompensavimo ir pašalpų vidinis auditas: gamybos sistemų užduotys ir rizika**

Santrauka

Šiame darbe pristatomas vienas teorinis tyrimas, atliktas norint parodyti vidinio audito svarbą kompensavimo procese. Ankstesni tyrimai šia tema dažniausiai buvo atlikti norint išanalizuoti ryšius tarp vidinio audito ir kelių (ar net visų) žmogiškųjų resursų funkcijų. Autoriai bandė atrasti visapusišką kompensavimo ir pašalpų vidinio audito modelį. Taip pat darbe aprašomi vidinio audito ir atlygio procesai, kurie, remiantis efektyvumu ir našumu, buvo integruoti į geresnio valdymo funkciją. Pagrindinis šio darbo tikslas buvo nustatyti vidinio audito priežastis procesams ir rizikai kompensavimo ir pašalpų žmogiškųjų resursų valdymo srityje.

Darbe panaudotas *registracinis* tyrimo metodas. Pirmia, autoriai išsamiai išanalizavo teorinę literatūrą apie vidinį auditą ir svarbiausius vidinio audito standartus. Toliau, remdamiesi organizacijų sistemų praktika ir literatūra apie žmogiškųjų resursų valdymą, buvo išanalizuotas atlygio procesas ir kompensavimo bei pašalpų struktūra. Po teorinės analizės autoriai į kompensavimo procesą įtraukė atitinkamus vidinio audito aspektus ir etapus, kur jie pabrėžė vidinio audito svarbą kompensavimo ir pašalpų struktūrose bei kompensavimo išlaidų kiekį (susijusį su kompensacijomis vadovams). Buvo išskirtos priežastys diegiant vidinį auditą, jo metu vykstantys procesai ir aprašytos pagrindinės žmogiškųjų resursų atlyginimo vidinio audito rizikos.

Žmogiškųjų resursų valdymas, kaip svarbiausias šiuolaikinių organizacijų resurso, *žmonių* valdymo sąvoka apima tam tikras funkcijas: planavimą, personalo formavimą (samdymas, atranka ir orientavimas), apmokymą, plėtrą ir karjeros tobulinimą, veiklos įvertinimą, kompensavimą ir pašalpas, išėjimą iš organizacijos ir kt.

Nagrinėjant žmogiškųjų resursų valdymą, ypač įdomi sritis yra kompensavimo ir pašalpų sistema. Kompensacijos yra vertinamos kaip pasaulinės bendrosios kultūros plėtros ir stiprinimo mechanizmas, pradinis bendrojo valdymo šaltinis, kuris labai aiškiai susieja atliktą veiklą su patirtais kaštais ir ryšiu tarp visų sudėtingų viešų pranešimų apie pagrindines temas, susijusias su bendru valdymu tarptautiniu mastu (Dowling, Festing, Engle, 2008) ypač, jei kalbame apie kompensacijas vadovams. Be to, kad kompensacijos yra svarbiausia žmogiškųjų resursų valdymo dalis tarnautojams ir vadovams, kaip finansinis atlygis už atliktą darbą, ši sritis taip pat yra viena iš sudėtingiausių gamybinių sistemų valdymo požiūriu. Kompensacijos yra tiesioginiai finansiniai organizacijos kaštai ir, jei atsižvelgsime į faktą, kad darbo kaštai gali parodyti didelį visų valdymo kaštų kiekį, atsiranda poreikis peržiūrėti kompensavimo sistemą investicijų požiūriu, o tai lems pridėtinę vertę. Kompensavimas ir pašalpos visada buvo labai jautri ir sudėtinga gamybinių sistemų žmogiškųjų resursų valdymo veikla. Kompensavimo modelis parodo finansinius ir nefinansinius atlygius, susietus su darbuotojų ir vadovų pastangomis ir veikla. Kadangi ši veikla yra vertinama kaip labai svarbi dėl dviejų priežasčių, (kompensavimas yra motyvuojantis veiksnys tarnautojams ir einamieji kaštai kompanijai), egzistuoja poreikis atlyginimo procesą padaryti efektyvesniu ir našesniu, siekiant patenkinti darbuotojų ir akcininkų viltis. Be to, daugybė apgavysčių, rizikos ir problemų, susijusių su kompensacijų vadovams kiekiu praityje, paskatino atsirasti valdymo ir kontrolės procesus.

Vienas galimas būdas pasiekti kompensavimo proceso efektyvumą ir našumą tinkamo valdymo, rizikos valdymo ir kontrolės požiūriu, yra vidinis auditas. Vidinį auditą galima apibrėžti kaip nepriklausomo ir objektyvaus patvirtinimo metodą, kuris padidina vertę ir pagerina organizacijos valdymą ir veiklą, taip pat palengvina susijusių procesų rezultatams pasiekti organizacijos tikslų.

Kompensavimo iš pašalpų proceso sudėtingumą galima paaiškinti taip. Pirmia, kompensacijos yra kompanijos veiklos kaštai, sudarantys iki 60% visų kompanijos veiklos kaštų (Štangl Šušnjar, Leković, 2009) ir juos reikia vertinti kaip investicijas į žmogiškąjį kapitalą. O kaštai gali būti tokie: tiesioginiai pašalpų kaštai arba pelno kaštai, kaip administravimas (Morley, Czarnecki, 2010). Taip vertinant, kompensavimo kaštai turi būti tinkamai valdomi; antra, kompensacijos ir pašalpos yra bendros kultūros mechanizmas ir sukuria vieną iš svarbiausių vadovų ir darbuotojų motyvavimo veiksnių. Motyvacija ir veikla yra formuojamos remiantis ryšiu tarp pastangų ir atlygio, ir pagal atlygio svarbumą arba valentingumą nagrinėjamam asmeniui (Brewster ir kt, 2007); trečia, anot Gupta (2004), vadovai sukaupė didžiulius turtus, o tai sudaro nedidelį ar netgi neigiamą tarpusavio ryšį su jų įnašu į jų kompanijų ilgalaikę veiklą. Vadovai gavo dosnius užmokesčius po neįdomios ar nesėkmingos veiklos laikotarpių. Ketvirta, kadangi kompensacijos ir pašalpos yra materialūs ir nematerialūs atlygiai darbuotojams ir vadovams, jos gali būti daugelio rizikų objektais, taip pat finansiniai atlygiai gali būti daugelio sukčiavimo atvejų objektais. Šios ir daugelis kitų temų, kurios buvo analizuojamos ankstesniuose tyrimuose visame pasaulyje ir buvo aprašyti šiame darbe lėmė tai, kad reikia nagrinėti vidinio audito įdiegimą kompensavimo procese.

Šio darbo rezultatai yra tokie, kad pagrindinė priežastis vidinio audito įdiegimui panaudojant suplanuotą etapų sistemą (informacijos kaupimas, įvertinimas, analizė ir veiklos planavimas) ir metodus (daugiausiai stebėjimus) yra gauti informaciją, kuri būtų naudinga visai organizacijai verslo procesų, susijusių su kompensacijomis ir pašalpomis, gerinimo požiūriu. Sritis, kuriose gali būti atliktas vidinis auditas yra strateginis žmogiškųjų resursų valdymas, darbo jėgos planavimas ir atranka; mokymas ir plėtra; kompensavimo ir pašalpų sistema; darbuotojo ir darbo santykiai; žmogiškųjų resursų informacinės sistemos ir t.t. Pagrindinės žmogiškųjų resursų kompensavimo vidinio audito sritys yra bendras plano kūrimas, kompensacijos pagrįstos grynaisiais ir akcijomis, atidėtos kompensacijos ir pašalpos bei pensijų įmokos. Taip pat kompensacijų ir pašalpų paketo vidinis auditas gali minimizuoti rizikas, kurios yra susijusios su žmogiškųjų resursų kompensacijų procesu (įdarbinimo rinkos rizika, reputacijos rizika, sutikimo rizika, išorinės partnerystės rizika, veiklos rizika, finansinių pranešimų rizika, ir t.t.), kur reputacijos rizika yra viena iš dažniausių priežasčių, kodėl reikia atlikti vidinį auditą. Nagrinėjant rizikos valdymą, naudojama keletas techninių priemonių. Dažniausiai naudojami stebėjimai, anketos, statistiniai ir kokybiniai metodai.

Raktažodžiai: *žmogiškųjų resursų valdymas, vidinis auditas, kompensacijos, pašalpos, rizika.*

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