Audit Department Management

The 1999-2000 Research Project
Conducted by The Dallas Chapter of The Institute of Internal Auditors

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Introduction

The Dallas Chapter Board of Governors approved the Research Committee to perform a study on management of the Internal Audit function. Our report is based on information obtained from Dallas Chapter members and current literature. The primary objective of the research project was to provide a service to Chapter members.

Project Scope
Management of the Internal Audit function was divided into three components as follows:

- *Audit Standards and Management Objectives* -- Assess whether members perceive a gap between the services they provide and the expectations of their respective organizational management, and, if so, identify factors contributing to the expectations gap.

- *Audit Department Administration* -- Identify the expectation model, or mission, adopted by member departments and assess its degree of influence on administrative decisions such as project selection, experience level of staff members, amount of outsourcing, and department organizational structure.

- *Appraising the Internal Audit Function* -- Identify the basis of performance measures, the types of activities measured and the methods used to measure performance.

Research Methodology
Both current literature and the experiences of committee members were utilized for survey development and survey analysis.

We developed the survey to obtain information from Dallas Chapter members. The targeted audience of the survey was members who hold management positions in their respective departments.

Two hundred thirty-six (236) Dallas Chapter IIA members were identified using the Chapter directory. Electronic mail messages were sent to each member identified requesting their participation in the survey. Fifty-four respondents completed the survey for an approximate response rate of 23%.

The survey was posted on our Chapter Web Site and members submitted their responses electronically via the Internet. Substantially all respondents (96%) were members of the Dallas Chapter and approximately 80% were either Audit Directors or Audit Managers.

Audit Department Management
Dallas Chapter IIA
Executive Summary

Demographics
All but two respondents were members of the Dallas Chapter of the IIA. Most of the survey respondents are members of large organizations. There did not appear to be a relationship to size of the organization and number of auditors in the audit department. However, it does appear as though audit department size is related to the industry of the respondent. Regulated industries such as banking, financial services and energy tended to have larger audit staffs. Average experience of audit staff was six years or greater.

Audit Standards and Management Objectives
A relatively small portion of respondents (29%) perceived an expectation gap between the audit services they provide and the expectations of their organization's management. Of those who perceived an expectation gap, 87% strongly agreed or agreed that executive management and/or the audit committee lack sufficient knowledge regarding the role of internal audit.

More than half of the respondents had seen the new definition of Internal Auditing *(as displayed at the bottom of page 6)* but only 18% thought that the definition would assist in reducing the expectation gap. Additionally, respondents indicated they operated according to the new definition even if they had not seen it prior to the survey.

Several respondents indicated that they disagreed with the standards, thought the standards were impractical or excluded services performed by their department, or planned to implement the standards in the near future. Given that all of our respondents indicated they were members of the IIA, we were surprised that respondents were unfamiliar with the standards or planned to implement the standards in the future.

External forces such as the *Blue Ribbon Commission on Audit Committees* may have a more profound affect on internal audit practice than the recently adopted definition of audit. "The Year of the Audit Committee", published in the April 2000 issue of Internal Auditor, highlights the following relevant points:

- "The audit committee's role is broadening;
- Audit committee member expertise, independence, time commitment, and resources---including an effective internal audit---are absolutely critical".

As audit committee's attempt to fulfill the expanding role, they will need resources to assist them. We would expect members of the profession to provide this expertise, which may ultimately change the practices of internal audit departments.

**Audit Department Management
Dallas Chapter IIA
Executive Summary**

Audit Department Administration
Most respondents indicated that more than one expectation model of audit applied *(model explanations provided on page 11)*. More than 80% of respondents indicated the compliance (due diligence) and professional audit (resource to the organization) models applied to their department.

Over half of the respondents indicated that audit department personnel decide what services audit will provide and what services or projects will be outsourced. A relatively small number of respondents spend 20% or more of their audit plan time on compliance auditing.

Information Technology auditing was the most frequently outsourced service. The number one reason why respondents outsource is because department personnel do not have the necessary skills to perform assignments.

The organization structure for most departments is minimal to medium hierarchy. Organizational structure was based on the size of the audit department and experience level of staff. Department head count is primarily budget driven.

Appraising the Internal Audit Function
Department performance measures tended to be based on the expectations of the audit committee, executive management, and the management of the audit department. Most respondents did not base their measures on the audit charter even though our research indicates the charter is really a contract among these three groups.

Qualitative measures of audit were considered highly effective although not as widely used, which may be a reflection on the difficulty of measuring the quality of our work. Larger audit departments were more likely to have formal measures related to project management.

In terms of methods used to measure performance, audit committee evaluations were not widely used although respondents thought this was an effective measurement tool.

More than half of the respondents felt their audit clients accepted ownership of internal control and that their department affected behavior modification within their respective organizations.

Audit Department Management
Dallas Chapter IIA
**Section A -- Demographics**

Demographic information was collected for profiling and evaluation of responses across the remaining survey sections. Questions in this section included IIA chapter affiliation, title, industry, number of employees in the respondent's organization and audit department, and the average years experience of audit staff. We expected to see a correlation between demographics and selected questions from other survey sections. *Detailed questions and responses for this section are included in Appendix A.*

Chapter Affiliation & Title
Fifty-four people completed the survey, all but two were members of the Dallas Chapter and 45 classified their title as Audit Director (General Auditor) or Audit Manager (VP).

Industry & Number of Employees
During 1997, 12 of the nation's largest private firms and nine of the nation's largest public firms were headquartered in the city of Dallas. A large portion of the city's labor market is concentrated in the service industry, wholesale and retail trade, and manufacturing. The profile of industries represented in this paper is shown in the graph below.
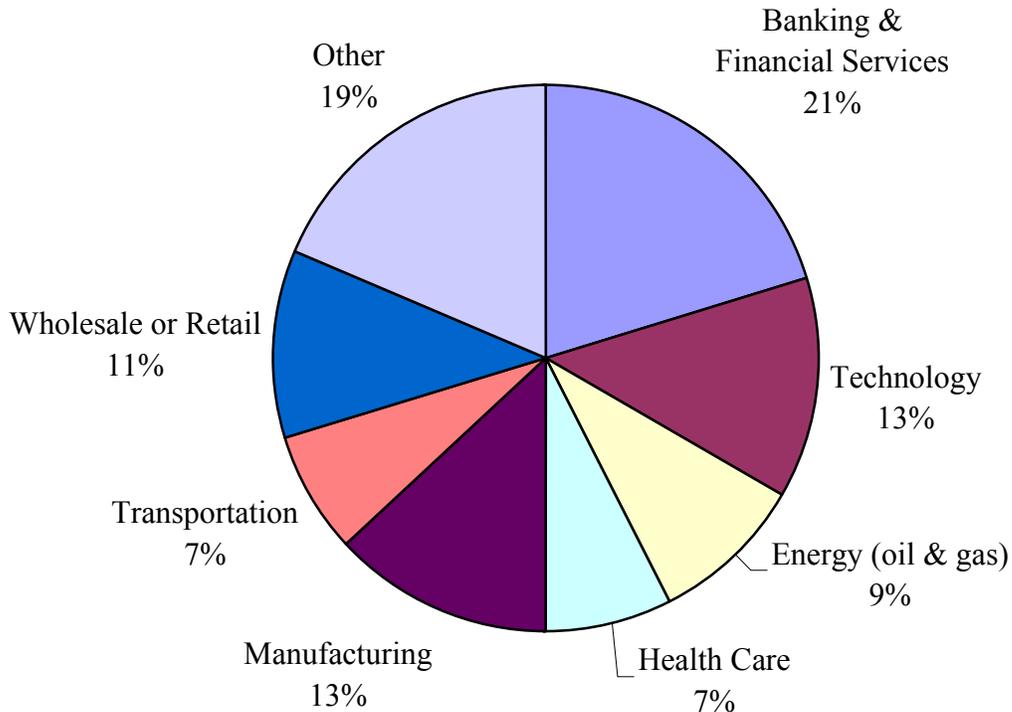

The "other" category represents member companies in Accounting, Legal and Consulting, Education, Government, Hotel Management, Hospitality, Real Estate and Construction, and Utilities.

Substantially all of the respondents (91%) were part of an organization with 1,000 or more employees.

Audit Department Management
Dallas Chapter IIA
Section A -- Demographics

Size of Audit Department
The number of auditors in reported departments tended to increase as the number of employees in the organization increased, although the increase in audit staff was not proportionate to the incremental increase in number of employees. The graph below shows the number of auditors and percentage of responses for each option provided on the survey.

More than 100
26%

51 to 100
0%

31 to 50
6%

21 to 30
9%

11 to 20
13%

Less than 10
46%
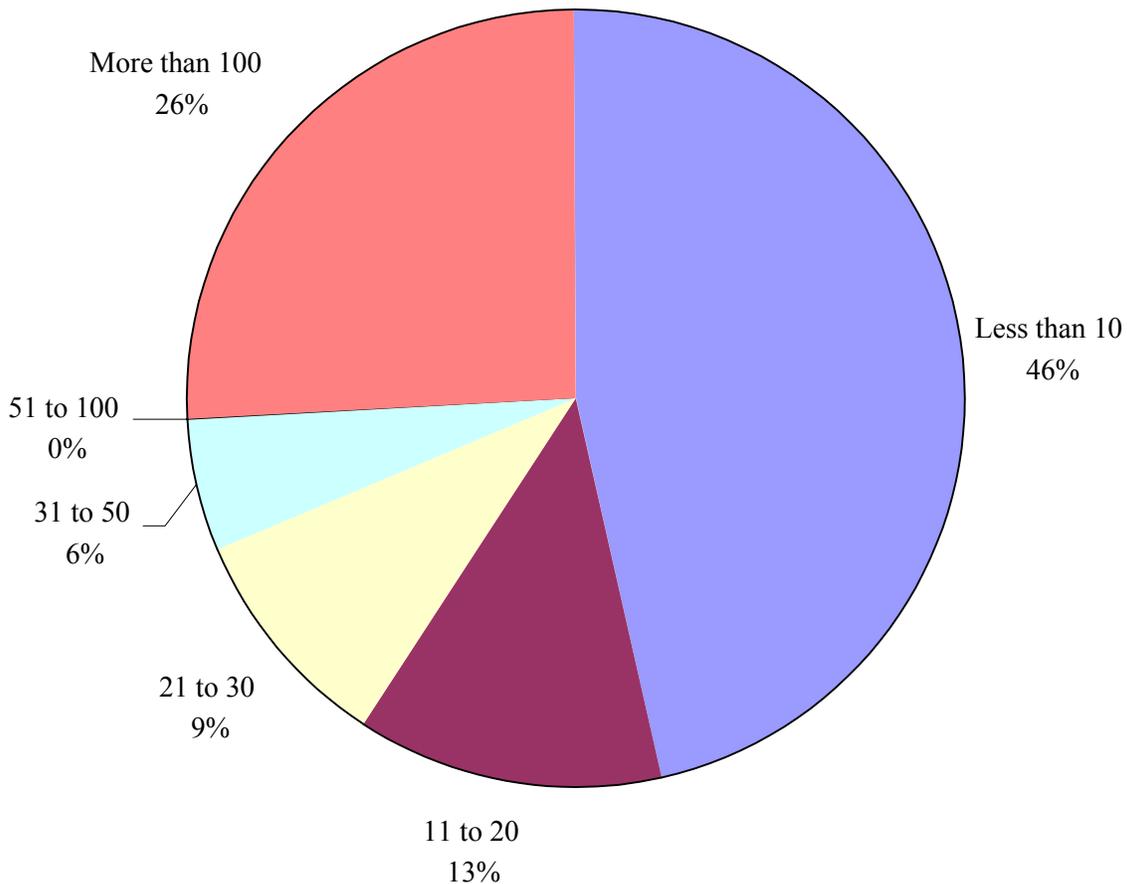
While 59% of the respondents work in organizations with at least 10,000 employees, only 41% of these organizations maintain an audit staff of 100 or greater. Almost half of the respondents reported a staff size between one and ten.

The industry that an organization operates in may have a stronger relationship to audit department size than the number of employees in the organization. Departments reporting more than 100 auditors tended to be in more regulated environments such as banking, financial services and energy. A government organization with 500 to 1,000 employees reported 100 or more auditors in the department.

Average Years Experience
More than half of the respondents indicated their staff had between six and ten year's experience. Another 23% indicated the average experience level was 10 years or greater.

Large organizations (10,000 or more employees) covered the spectrum of inexperienced to experience, although the majority reported an average of six or more years. The table below lists all of the responses by average year's experience and organization size.

Employees in Organization	Number of Responses Based on Average Years Experience of Staff					
	Less than 2	2 to 5	6 to 10	More than 10	Could not categorize	Totals
Unknown			1			1
0 to 50				1		1
51 to 250			1			1
251 to 500		1				1
501 to 1,000				1		1
1,001 to 5,000		2	8	1		11
5,001 to 10,000			4	2		6
More than 10,000	3	4	17	7	1	32
Totals	3	7	31	12	1	54

Section B Objective
The Audit Standards and Management Objectives was included primarily to assess whether members perceive a gap between the services they provide and the expectations of their organizational management. We were also interested in member perceptions regarding the new definition of internal audit and assessing whether they thought this definition would bring about change in their practices.

Literature Review and Background
During June 1999 the IIA's Board of Directors unanimously approved a new definition for internal audit, which was provided by the Guidance Task Force (GTF) of the IIA. According to the authors of "Where We're Going", published in October 1999, many members of the GTF thought the definition provided in the *Statement of Responsibilities of Internal Auditing* did not adequately reflect the evolution of practice. The GTF premises underlying the new definition follow:

- The internal auditing profession will be delineated by how well its services are performed, rather than by who performs them or what they are.

- To remain viable, the internal auditing profession needs to be perceived as adding value to organizations.

- Internal auditors must adopt the perspective of the entire value chain.

- Internal auditing's conceptual structure must reach beyond its own inherent processes to reflect organizational service drivers.

- Standards and other professional guidance must not only lead the profession but must also come to symbolize distinctive quality to the marketplace.

Additionally, our interest in this topic is the result of our own professional experiences and interactions with other professionals through the IIA.

- From time to time, members express concern about the likelihood of their department being outsourced. This should not be a concern if we are meeting our organization's needs and providing quality, relevant, cost-effective services. But, in meeting our organization's needs are we complying with Professional Standards?

- Some members do not believe that Control Self-Assessment (CSA) is supported by the Professional Standards and are concerned that engaging in this service would impair their objectivity.

- Lastly, the people who set our professional standards do not pay our salaries. In today's marketplace, there are greater demands being placed on all individual's in organization's and many people feel the pressure to deliver more with less.

For these reasons, we wondered if audit practice and the profession are aligned.

Survey Results

1.a.   Do you perceive a gap between the services you provide and the expectations of your organization's management?

Of the 51 individuals that responded to the above question, 15 (29%) said that there is an expectations gap and 36 (70%) did not feel that there was an expectations gap.

Overall, the percentage of respondents who perceived an expectations gap was not high. In a detailed cross comparison to size of the organization, respondents from organizations with 1,000 or fewer employees were almost twice as likely to perceive an expectation gap than their counterparts at large organizations. Only 27% of the respondents from large organizations perceived an expectation gap, whereas 50% of the respondents from small organizations perceived an expectation gap.

1.b.   If you perceived an expectations gap in '1.a.', do you agree or disagree that the following contributed:

Twenty-five people responded to the follow-up question, although only 15 respondents perceived a gap in question '1.a.'. The tables below show the combined responses of both groups (those who perceived a gap and those who did not). The first table lists the potential causes or reasons for an expectation gap and the percentage of those that strongly agreed or agreed that these factors were causes or reasons for the expectation gap. The second table is constructed the same way but lists the percentage of those that disagreed or strongly disagreed that each factor caused the expectation gap.

Strongly Agree or Agree	Combined Perceptions (25)
Executive management and/or the audit committee lack sufficient knowledge about the role of internal audit.	52%
Organizational management would like for us to provide consulting services but we have declined due to restrictions in the professional standards	8%
Resource constraints, either in terms of available hours or skill sets of personnel, have prevented our department from undertaking certain types of projects.	52%
Our department is not flexible in responding to organizational management requests.	12%
Attitudes of department personnel or a lack of awareness of developments in the audit profession may prevent our department from performing according to expectations.	36%

We performed a detailed analysis of the responses to part 'b' based on whether or not the respondent perceived a gap in question '1.a.' With one exception, the potential causes were rated similarly regardless of the respondent's perception as to the existence of a gap. Our review of the data indicated:

- 87% of respondents who perceived a gap strongly agreed or agreed that executive management and/or the audit committee lack sufficient knowledge regarding the role of internal audit.

- Conversely, 80% of the respondents who did not perceive a gap disagreed or strongly disagreed that executive management and/or the audit committee lack sufficient knowledge.

Disagree or Strongly Disagree	Combined Perceptions
Executive management and/or the audit committee lack sufficient knowledge about the role of internal audit.	36%
Organizational management would like for us to provide consulting services but we have declined due to restrictions in the professional standards	76%
Resource constraints, either in terms of available hours or skill sets of personnel, have prevented our department from undertaking certain types of projects.	28%
Our department is not flexible in responding to organizational management requests.	68%
Attitudes of department personnel or a lack of awareness of developments in the audit profession may prevent our department from performing according to expectations.	48%

Overall the respondents who did not perceive a gap either disagreed or strongly disagreed with all of the potential causes. A high percentage from both groups of respondents disagreed that consulting services were declined due to restrictions in professional standards.

2.   Prior to this survey, had you seen the new definition of Internal Auditing?

Of the 51 respondents who answered this question, 33 (65%) had seen it and 18 (35%) had not.

The new definition of internal auditing is as follows:
"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." (Krogstad / Ridley / Rittenberg, p. 29).

3.   The new definition will reduce or eliminate the expectation gap perceived in '1.a.'?

Out of the 49 individuals that responded, only 9 (18%) thought that the new definition would help eliminate the gap. Approximately half of the respondents were neutral regarding the impact of the new definition, and another 32% disagreed (or strongly disagreed) that the definition would help eliminate the gap.

Response	# Responses	% Response
Strongly Agree	1	2%
Agree	8	16%
Neither Agree nor Disagree	24	49%
Disagree	12	24%
Strongly Disagree	4	8%
Total Responses	49	100%

Those who perceived an expectation gap were neutral or disagreed that the definition would eliminate the expectation gap. For those who perceive a gap, it will take more than a new definition to ensure audit is meeting management's expectations. The chart below summarizes the data we used to support our conclusion. *Note: Numbers may not equal 100% due to rounding.*
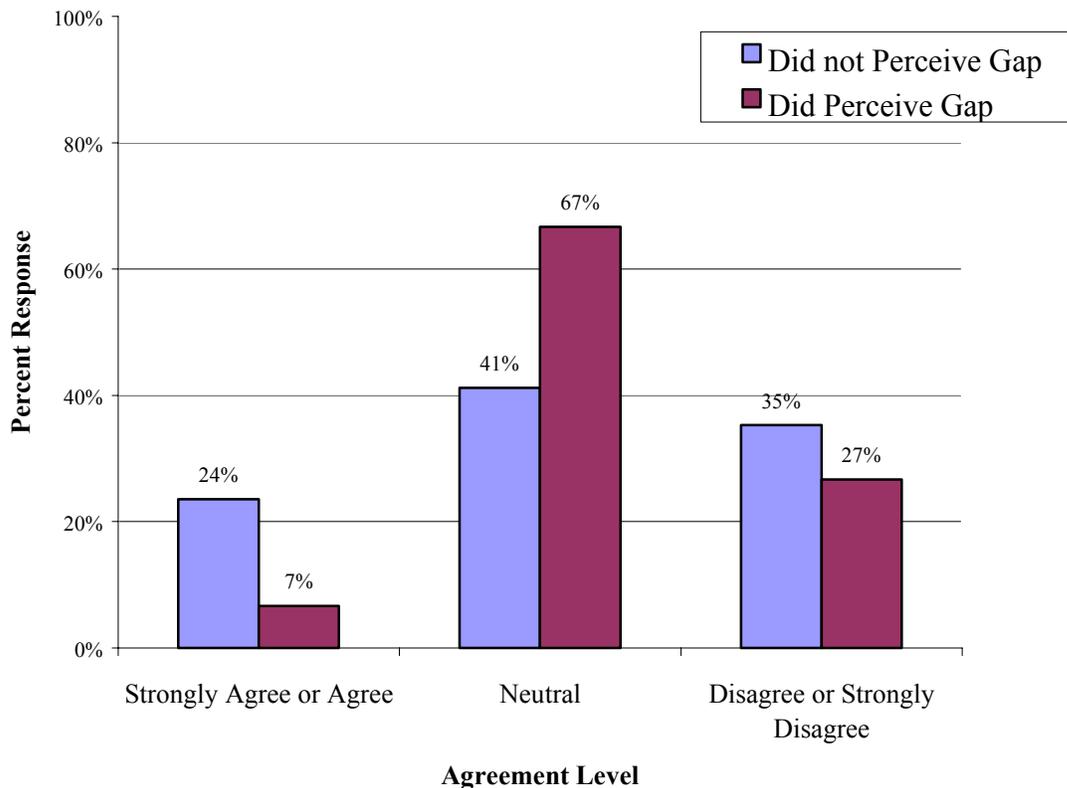
4.a. You operate according to the new definition:

Provided Response	Strongly Agree or Agree	Neutral	Strongly Disagree or Disagree
Perform independently and objectively	47	2	2
Perform assurance and consulting (e.g. assess as well as facilitate changes)	46	0	0
Add value and improve an organization's process	48	0	0
Align internal auditing process with organization's critical success factors and core processes (e.g. help organization accomplish its business objectives)	44	0	0
Evaluate and improve effectiveness of risk management, control and governance process using systematic, disciplined approach	43	0	0

Substantially all of the respondents agreed that they were operating according to the new definition even if they had not seen the definition prior to the survey. Additionally, respondents did not seem to think the new definition significantly changed their practice (as noted in question '5' below). In section D of the survey, we asked respondents if their department performance measures were based on Professional Standards.
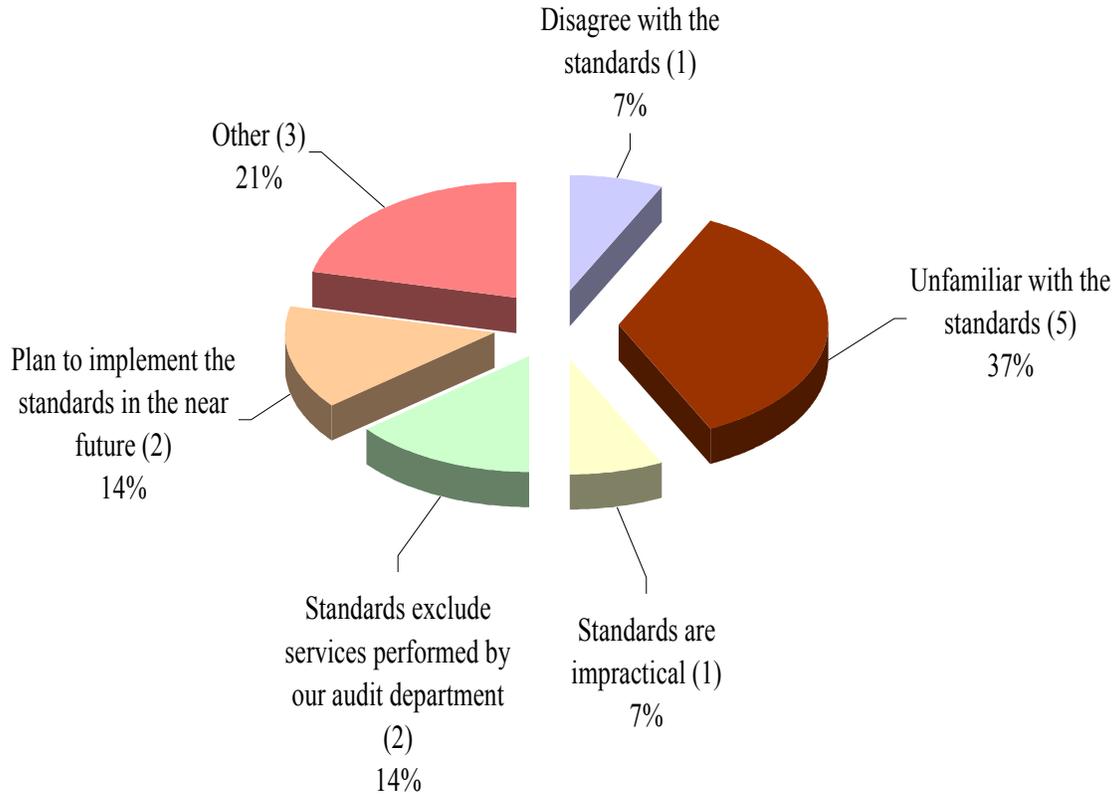
Based on the responses from all of these questions, we believe there are potential implications for the IIA and its members. Although our survey did not delve deep enough into this area to draw definitive conclusions, we believe these responses indicate that members are leading the IIA instead of the other way around; they perform as they see fit regardless of standards. If this is correct, does this mean members see the IIA as behind the times? Are there ethical concerns if members are performing according to their standards instead of those of the profession? We would recommend the IIA further explore this area with members to validate the responses we received with a wider audience.

4.b. If you do not adhere to the new definition, please indicate the following that explain why (check all that apply)?

Only respondents who did not adhere to the new definition were expected to respond to this question. Respondents were instructed to select all of the possible choices that applied to them. Overall, we received a relatively low number of responses to this question compared to other questions in the Section (approximately 27% of respondents assuming 51 respondents for most of Section B questions).

The chart below shows the number (in parentheses) and percent of responses per option provided.

Disagree with the
standards (1)
7%

Other (3)
21%

Unfamiliar with the
standards (5)
37%

Plan to implement the
standards in the near
future (2)
14%

Standards exclude
services performed by
our audit department
(2)
14%

Standards are
impractical (1)
7%

In the demographics portion of our survey, all respondents indicated they were members of the IIA. Therefore, we thought it was interesting that two respondents planned to implement the standards in the future and that five members were unfamiliar with the standards.

5.   **If you are operating under the new definition, then adoption of the new definition changed the practice of your department:**

Provided Response	Strongly Agree or Agree	Neutral	Strongly Disagree or Disagree
Project selection	18	7	20
Performing different projects	17	8	20
Staff recruitment, training and supervision	17	7	20
Increase the time required to complete projects	8	14	23
Decrease the time required to complete projects	1	18	18
Increase the number of projects outsourced	9	12	24
Decrease the number of projects outsourced	0	15	30
Increase the variety of projects outsourced	4	15	26
Decrease the variety of projects outsourced	1	17	27
Working with management & audit client	17	8	20
Different methods of administrating the audit department	17	8	20
Different methods of appraising the audit department	19	10	16

Based on provided responses, it would seem that the new definition has not had a significant impact on practice. We believe there are several interesting findings as follows:

- Respondents did not think the new definition would have an impact on the amount of outsourcing.

- A majority of respondents agreed the new definition would result in different methods of appraising the audit department.

- Respondents were split on whether the new definition would impact project selection or the performance of different projects (or, provide different services).   We thought this was interesting given that the new definition expanded the scope of audit to include assurance and consulting services.

Section C Objective
The Audit Department Administration section was included to identify the applicable expectation model(s) utilized by a department, determine if and how the model influences administrative decisions such as audit services provided and organizational structure of the audit department.

Literature Review and Background
John D. Tongren in his article titled "Integrated IT Audit -- Part I", issued March 1, 1999, asserts the expectations for internal audit departments fall into three general models as follows:
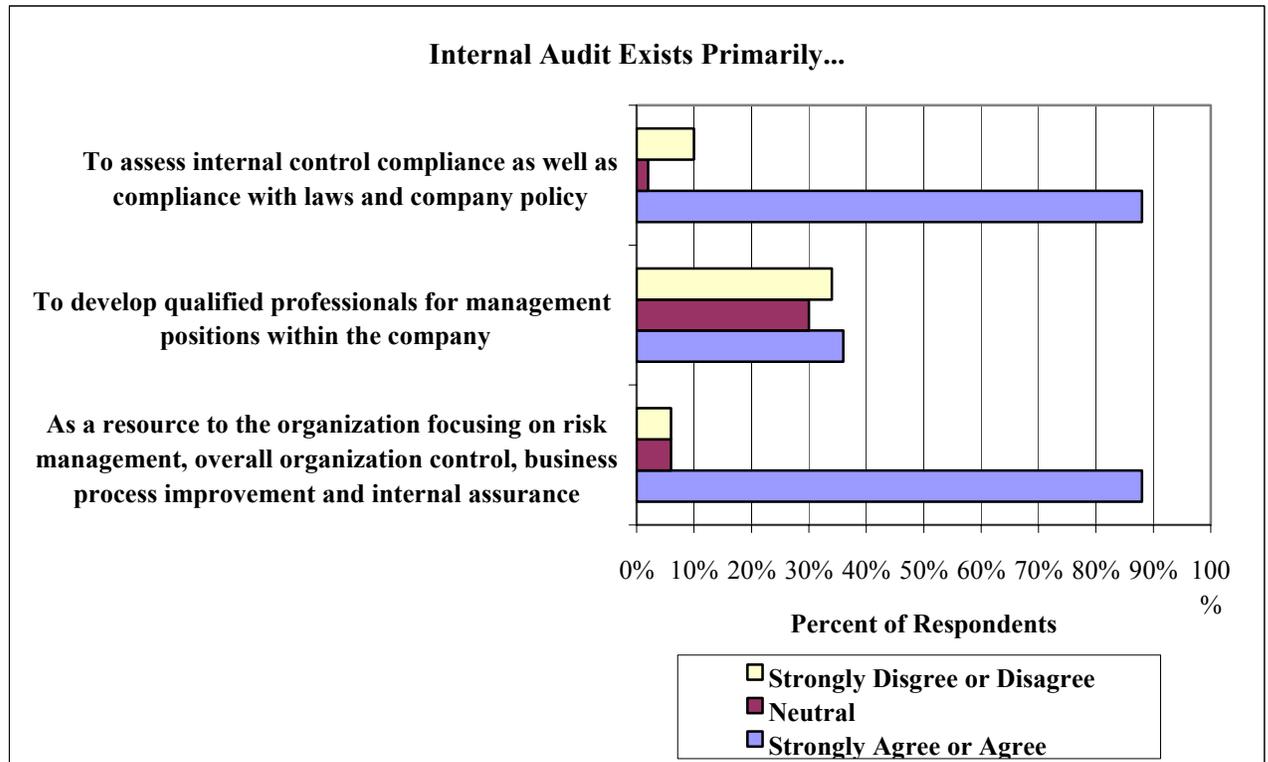
- *Due Diligence* -- This model asserts that "internal audits exists primarily to demonstrate that management and the board are concerned about internal control, and to limit legal liability. Internal audit focus is on internal control and fraud. It is hoped that internal auditors will make some comments that are useful, will not cause too much disruption to operations, and will hold costs at a bare minimum." In our survey, we considered this model as compliance oriented.

- *Staffing and Development Internal Audit Model* -- This model asserts that "internal audit exists primarily as a point of entry into the organization and as a management development function for qualified professionals. Internal audit focus is on internal control, operational improvement, and staff development. It is hoped that internal auditors will learn our way of doing business, make constructive comments to improve operations and gain polish and poise before they move on to a real job." We considered this the management development model.

- *Professional Internal Audit Model* -- This model asserts that "internal audit exists primarily as a resource to the organization. Internal audit focus is on risk management, overall organization control, business process improvement, and internal assurance. Here it is hoped that internal audit will be appreciated and contribute meaningfully to the organization." In our survey, we interpreted this as the professional audit model.

The expectation models really are the mission, or reason for existence, of the audit department. There are implications associated with any of the selected models. For example, we expected to see a broader range of audit services associated with the Professional Internal Audit Model. We also expected that the skills sets of personnel, experience level of personnel and career path for personnel would be different for staff based on the adopted model. Finally, we expected to see a correlation between respondents who perceived an expectation gap in Section B and the adopted model. For example, we anticipated that respondents with a compliance oriented model would be more likely to perceive an expectations gap than those respondents who utilize a professional audit model.

Audit Department Management
Dallas Chapter IIA
Section C -- Audit Department Administration

Survey Results

1. **Do the following expectation statements of audit apply to your department? Internal audit exists primarily to:**

Internal Audit Exists Primarily...

To assess internal control compliance as well as compliance with laws and company policy

To develop qualified professionals for management positions within the company

As a resource to the organization focusing on risk management, overall organization control, business process improvement and internal assurance

Percent of Respondents

☐ Strongly Disgree or Disagree
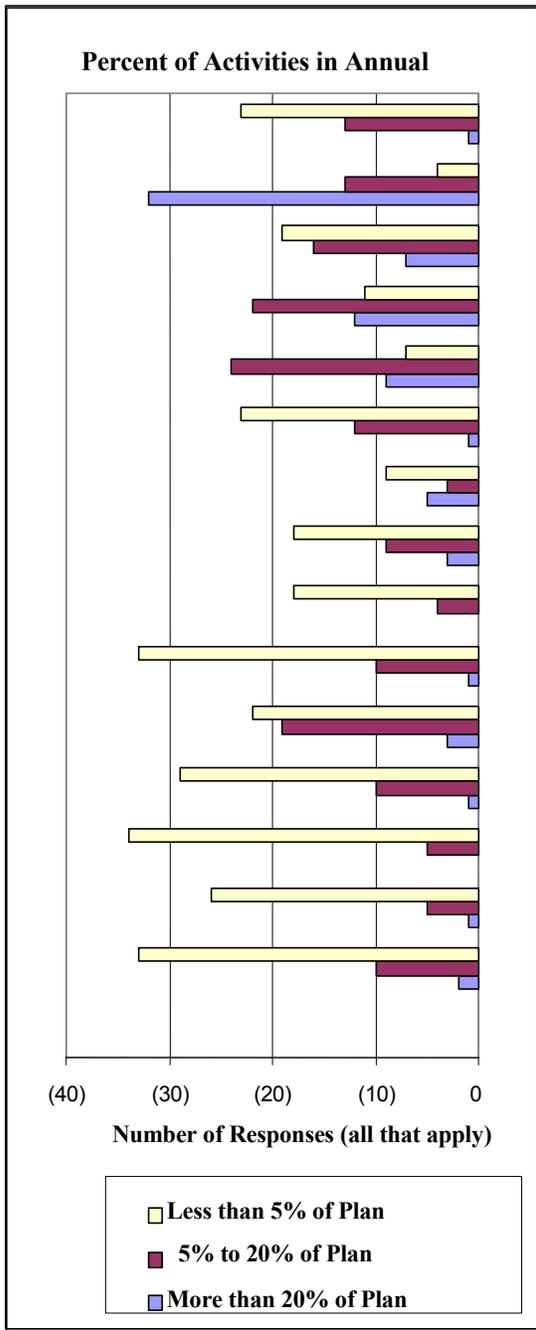■ Neutral
☐ Strongly Agree or Agree

The fifty respondents agreed almost equally with both the traditional compliance auditing expectation (first one) as well as the professional audit model (last one). The challenge of the audit departments is to balance between these two expectations. The next question attempts to break down the audit activities included in an annual plan to see if the planned activities meet the expectations.

Shown on the next page, activities planned do address both the compliance auditing and professional auditing models. However, less time is planned on compliance related activities. For example, only 12 respondents spend more than 20% of their time on compliance audits. On the other hand, all of the fifty respondents participate in operational auditing (zero respondents for "do not engage") with 32 respondents spending more than 20% on them. However, an interesting point is that the activities even more closely related to the "professional audit model" (such as "Management Consulting and Advisory"), are still only a small part of the audit plan or less than 5% (see top bar for each activity).

2.a. **Estimate the percentage of your annual plan that is devoted to the following activities (Performed by Audit Staff; should add to approximately 100%):**
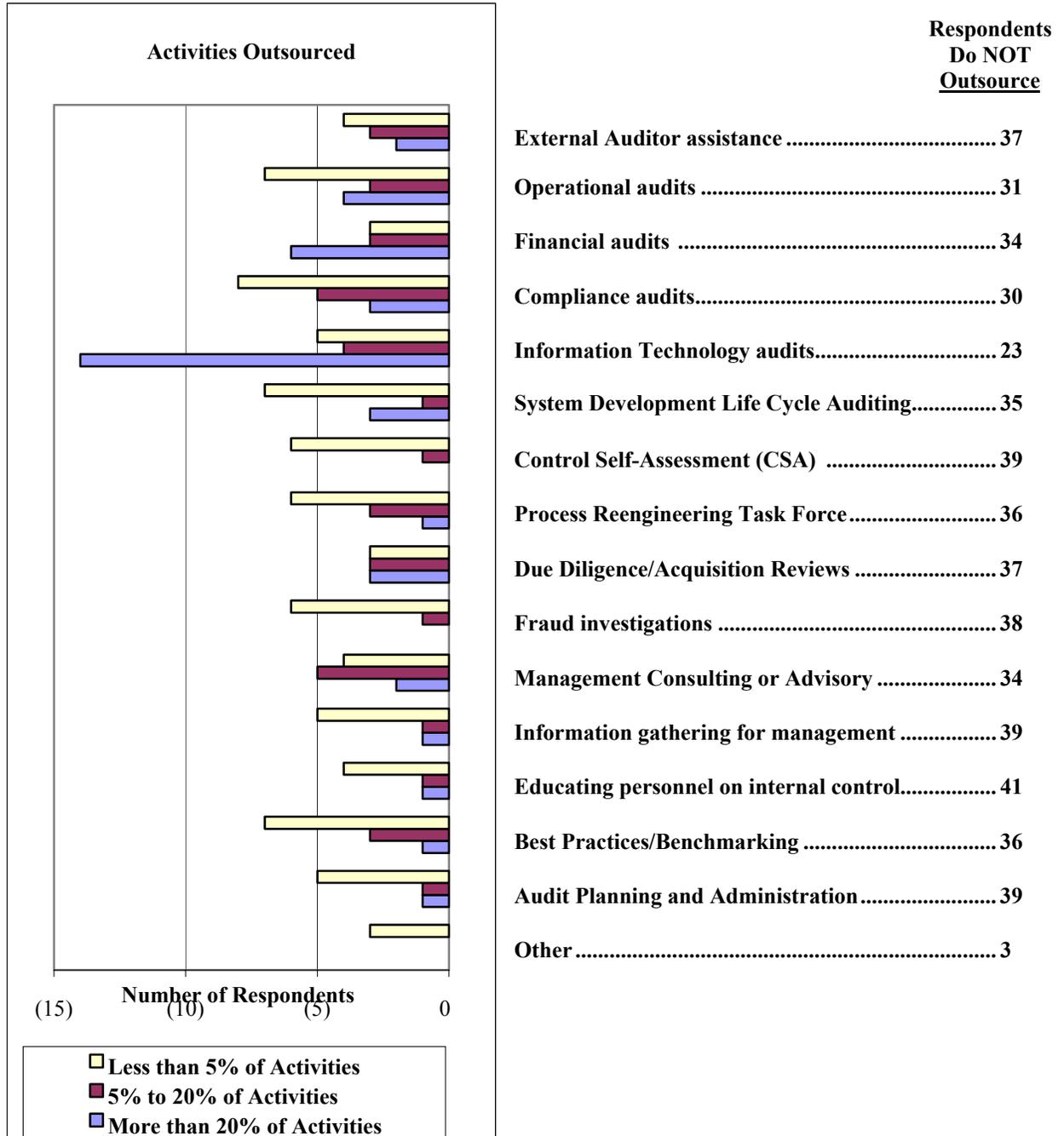

Percent of Activities in Annual

Number of Responses (all that apply)

Less than 5% of Plan
5% to 20% of Plan
More than 20% of Plan

Respondents Do NOT Engage

External Auditor assistance...................................... 13

Operational audits 0

Compliance audits 5

Financial audits... 7

Information Technology audits 10

System Development Life Cycle Auditing 14

Control Self-Assessment (CSA) 33

Process Reengineering Task Force........................... 19

Due Diligence/Acquisition Reviews 27

Fraud investigations 6

Information gathering for management 10

Management Consulting or Advisory...................... 5

Educating personnel on internal control 11

Best Practices/Benchmarking.................................. 17

Audit Planning and Administration......................... 4

To transition the audit department expectations and plan to audit department administration, the following questions were asked about outsourcing.
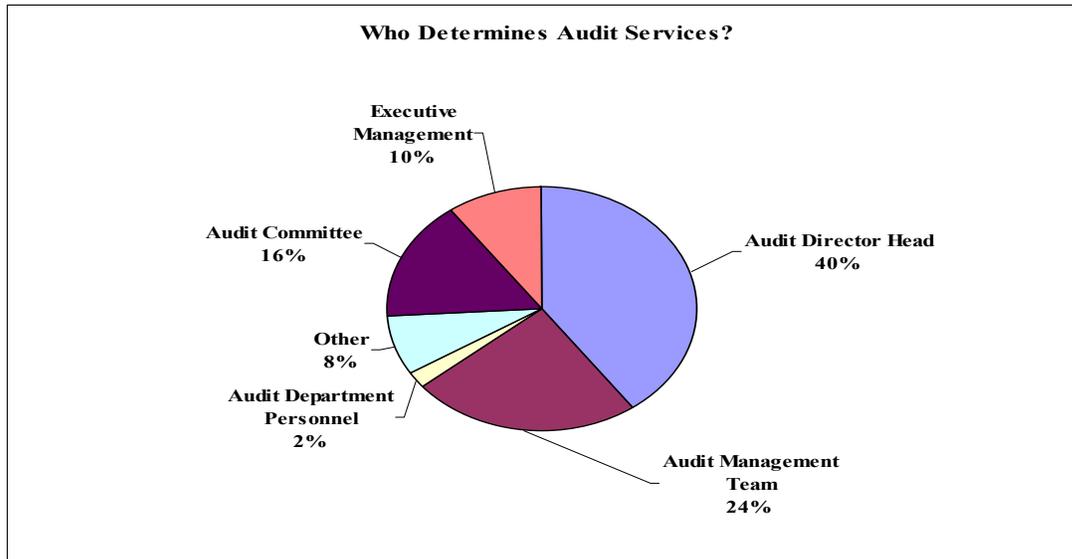
2.b. Estimate for each listed activities the percentage of all Outsourced Activities (Should add to approximately 100% of all that is Outsourced):

Activities Outsourced

	Respondents Do NOT Outsource
External Auditor assistance	37
Operational audits	31
Financial audits	34
Compliance audits	30
Information Technology audits	23
System Development Life Cycle Auditing	35
Control Self-Assessment (CSA)	39
Process Reengineering Task Force	36
Due Diligence/Acquisition Reviews	37
Fraud investigations	38
Management Consulting or Advisory	34
Information gathering for management	39
Educating personnel on internal control	41
Best Practices/Benchmarking	36
Audit Planning and Administration	39
Other	3

Number of Respondents

(15) (10) (5) 0

□ Less than 5% of Activities
■ 5% to 20% of Activities
■ More than 20% of Activities

Information technology audits are the most outsourced.

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3.   **Who in your organization determines what services internal audit will provide? (Check best answer)**

Who Determines Audit Services?

- Executive Management 10%
- Audit Committee 16%
- Other 8%
- Audit Department Personnel 2%
- Audit Director Head 40%
- Audit Management Team 24%

Sixty-six percent (66%) of the respondents indicated that audit department personnel were responsible for determining audit services. Other responses provided included the CFO (two responses) and a combination of the Audit Committee and Executive Management (two responses)
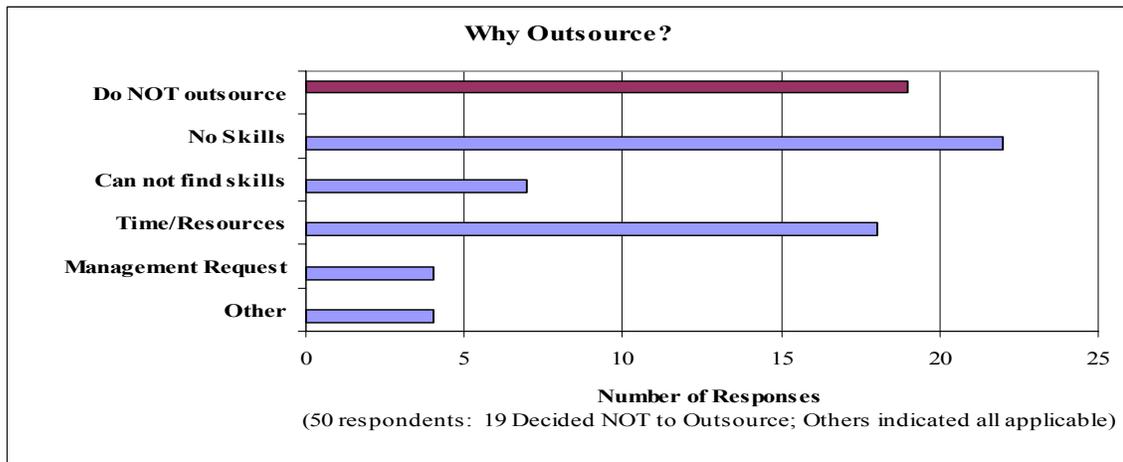
4.   **Who in your organization makes the decision to outsource audit services? (Check all that apply)**

Who decides to Outsource?

(50 respondents: 10 Do NOT Outsource; Others indicated all applicable)
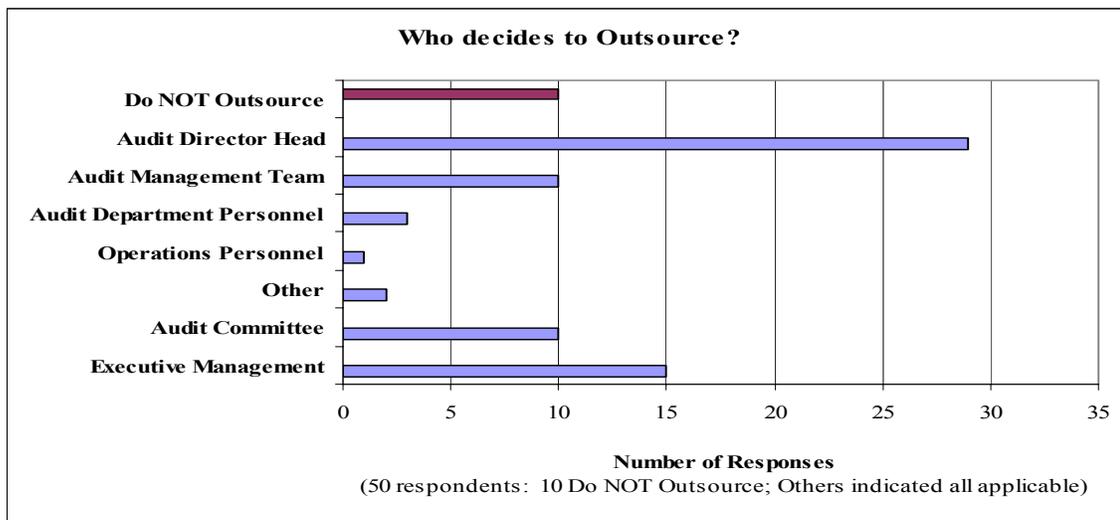
Similar to the previous question, audit department personnel are most likely to make the decision to outsource activities. The CFO accounted for the responses indicated in the graph as "other".
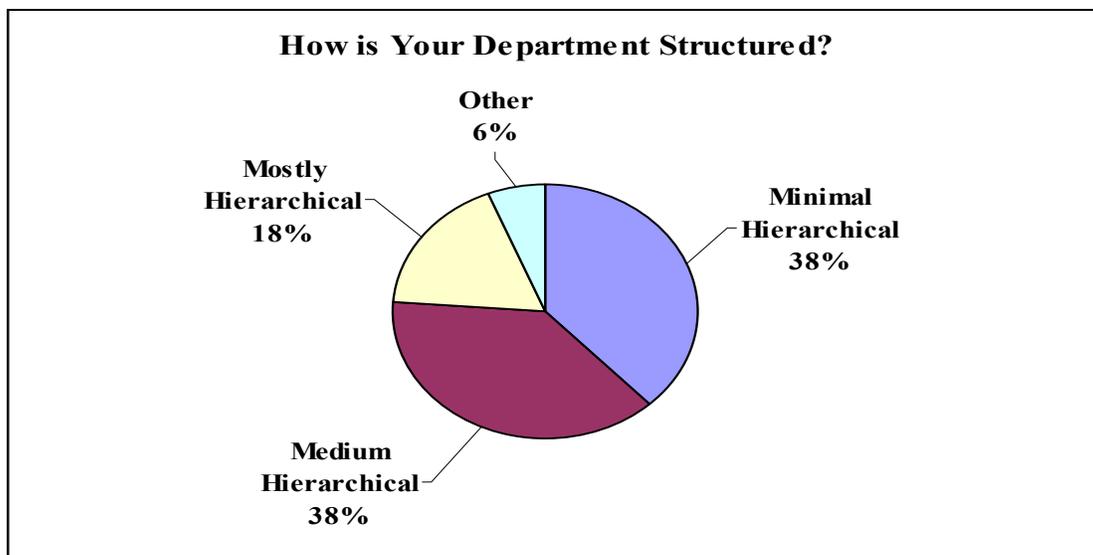
5.   Why do you outsource Audit services? (Check all answers that apply)

Why Outsource?

Do NOT outsource	
No Skills	
Can not find skills	
Time/Resources	
Management Request	
Other	

Number of Responses
(50 respondents: 19 Decided NOT to Outsource; Others indicated all applicable)

The primary reason for outsourcing is that department personnel do not have the necessary skills to perform a specific assignment.

6.   How is your audit department structured? (Check the one statement that applies)

How is Your Department Structured?

- Other 6%
- Mostly Hierarchical 18%
- Minimal Hierarchical 38%
- Medium Hierarchical 38%

Minimal hierarchical suggested staff works in teams, medium hierarchical suggests a team structure with planning and other critical decisions made at the management level, and mostly hierarchical suggested various levels of management, supervisors and staff. The question did not apply well to three respondents due to the size of their departments. One respondent in the "other" category indicated that substantially all of the department activities were outsourced.
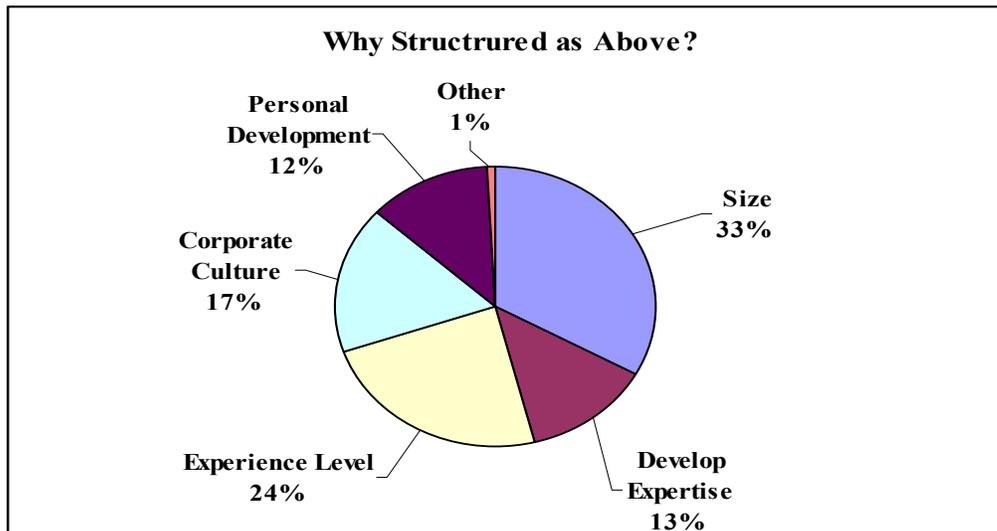
7. How is your audit department administered (check the one statement that applies)

The choices provided in the survey and results follow:

- 72% (36/50) report to the same manager (or General Auditor) for audit assignments and administration.

- 26% (13/50) administratively report to one manager but are pooled among managers for audit assignments.

- 2% (1/50) indicated that team managers are assigned to operating units.

8. Why is your department structured as you answered in question 6 above?
    (Check all answers that apply)

Why Structrured as Above?

- Personal Development 12%
- Other 1%
- Size 33%
- Corporate Culture 17%
- Develop Expertise 13%
- Experience Level 24%

Size of the audit department and experience level of staff were the two primary reasons for the organizational structure of the department. Our detail analysis revealed those large companies with very experienced audit staff tended to have less hierarchy.

The final question in this section provided additional insight as to expectations and administration.

9.   **Which of the following criteria determine the number of staff necessary to fulfill internal audit's role? (Check the best answer)**

How Determine Number of Staff?
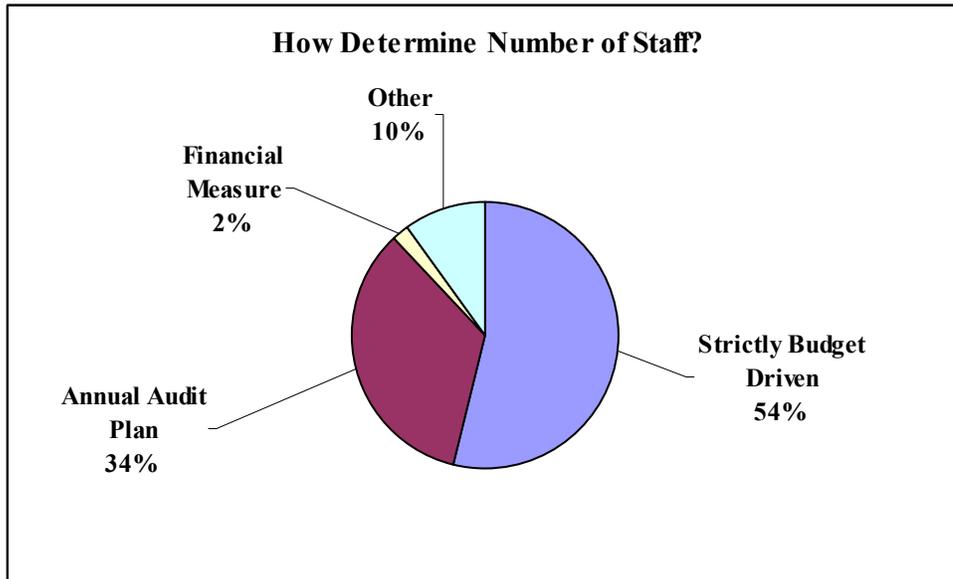
Regardless of the expectation model(s) adopted, over half of the departments still base resourcing decisions on available budget dollars.

Other responses included:
- Combination of audit plan and budget
- Comparison to other companies in same business
- Audit committee decides;
- Management set full time equivalent limits for all overhead functions

Section D Objective
Appraising the Internal Audit Function was included to identify the basis of performance measures utilized by respondents, identify the types of activities measured and the methods used to measure performance.

Literature Review and Background
We expected a relationship to exist between appraisal of the audit function (Section D) and the expectation model adopted by the department (Section C). We were interested in determining if the audit charter was the basis of performance and influenced the activities that were measured.

Charles Zhang published an article titled "A Check-up for Your Charter" in the October 1999 issue of the *Internal Auditor* magazine. Mr. Zhang sees the charter as a binding contract between the audit committee, senior management and the internal audit function. The charter defines the expectations for the three parties to the contract and thus establishes some parameters for measuring the effectiveness of internal audit in carrying out its duties.

According to Mr. Zhang:

"The demands of the organization and advances in audit methodology may have created a new internal audit process that scarcely resembles the traditional internal audit described in the charter. In such situations, outdated audit charters can create a significant 'expectations gap' for the internal audit function."

Additionally, he states:

"If the audit charter has not been revised to accommodate such evolution, auditors may not be complying with their charter's responsibility statement, providing clear direction for staff, or meeting the expectations of their audit committee and others…..While explanations can obviously be made to the audit committee, the gap between current practice and what is presented in the charter can create an embarrassing scenario for the audit director and the department."

Survey Results
1.   **Your department performance metrics are based on which of the following (check all that apply):**

| Performance Measures	Number Of Responses
Professional Standards	23
Executive Management Expectations	29
Audit Charter	16
Audit Client Expectations	17
Audit Committee Expectations	30
Have No Formal Measurements	10
Audit Department Management Expectations	30
Other (1)	3

Note: (1) - Other responses included "Value Added To Management, Cost Recoveries/Potential Savings; and Strategic Objectives".

According to respondents, the audit committee, executive management and audit department management expectations are key in developing performance measures. Only about one-half of the respondents used the Audit Charter as a basis for measurements, which is interesting based on the suggestions provided by Mr. Zhang. Both the audit committee and executive management are parties to the contract he refers to as the audit charter. The results seem to indicate that respondents disagree with Mr. Zhang or perhaps have not considered the charter in the same way.

2.a. **Do your performance measures include any of the elements listed below (check all that apply)?**
2.b. **Do you agree that these elements are effective measures of audit department performance? Rate your degree of agreement regardless of your answer(s) in part 'a'.**

The bars in the chart below represent the number of respondents who utilize each performance measure. The line shows the average perceived effectiveness of the plotted measures, where a five indicates the respondents Strongly Agreed (on average) and a one indicates the respondents Strongly Disagreed (on average). Due to the number of measures rated on this question, only the higher rated (more effective) measures were plotted. *See Appendix A for results.*
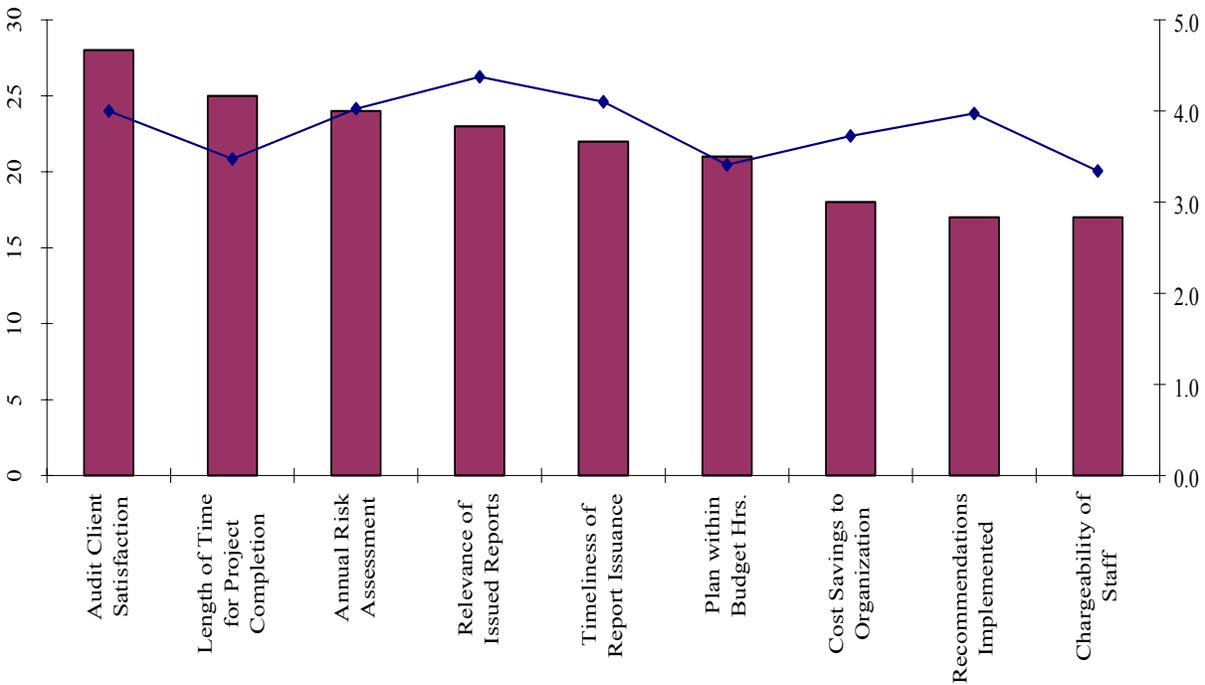
Above Average Rated Performance Measures

The graph illustrates that measures considered as highly effective are not utilized on a consistent basis. The annual risk assessment process, timeliness and relevance of report issuance were deemed effective measures of audit department performance, although less than half of the (49) respondents actually measures these activities.

Detailed cross analysis of measures based on audit department size revealed that large audit departments were much more likely to rate "Audit Plan within Budgeted Hours" and "Audit Plan within Budgeted Dollars" as effective measures. Based on Committee experiences, we believe these activities are probably formally measured out of necessity. Perhaps as a department grows in size, project management becomes increasingly difficult and more important to manage. With a large staff, dollars/hours can be lost quickly. The budgets for these departments are probably quite large and there may be more pressure from the organization for cost-effective performance.

The conclusion of the Committee is that the qualitative aspects of audit department performance are difficult to measure, which may explain the results obtained through our survey.

3.a. What methods do you utilize to measure performance (check all that apply)?
3.b. Do you agree that these are effective measures of performance? Rate your degree of agreement regardless of your answer(s) in part 'a'.

The results for both parts of this question are summarized in a chart on the following page. The most significant findings from our detailed analysis follow:

- The most widely used and most effective (higher than average effectiveness rating) tools for measuring performance are Annual Personnel Appraisals, Supervision on Audits, Audit Client Evaluations and Development Plans for Audit Department Personnel.

- Only 9 respondents indicated that they use Audit Committee Evaluations as a tool, although 77% of respondents rated this as an effective method of measuring performance.

- More traditional methods of measuring performance (i.e., comparison of audit plan to budgeted hours) were not rated as highly effective tools, although they are highly used in practice.

- Project management and time management software, work group reviews and self evaluations were not widely used or seen as effective as other tools used for measuring performance, although detailed analysis revealed that larger department were more likely to find these effective tools (again probably due to necessity of monitoring).

The bars in the chart below represent the number of respondents who utilize each method of measuring performance. The line shows the average perceived effectiveness of the plotted methods, where a five indicates the respondents Strongly Agreed (on average) and a one indicates the respondents Strongly Disagreed (on average). Due to the number of measures rated on this question, only the higher rated (more effective) measures were plotted. S*ee Appendix A for all results.*
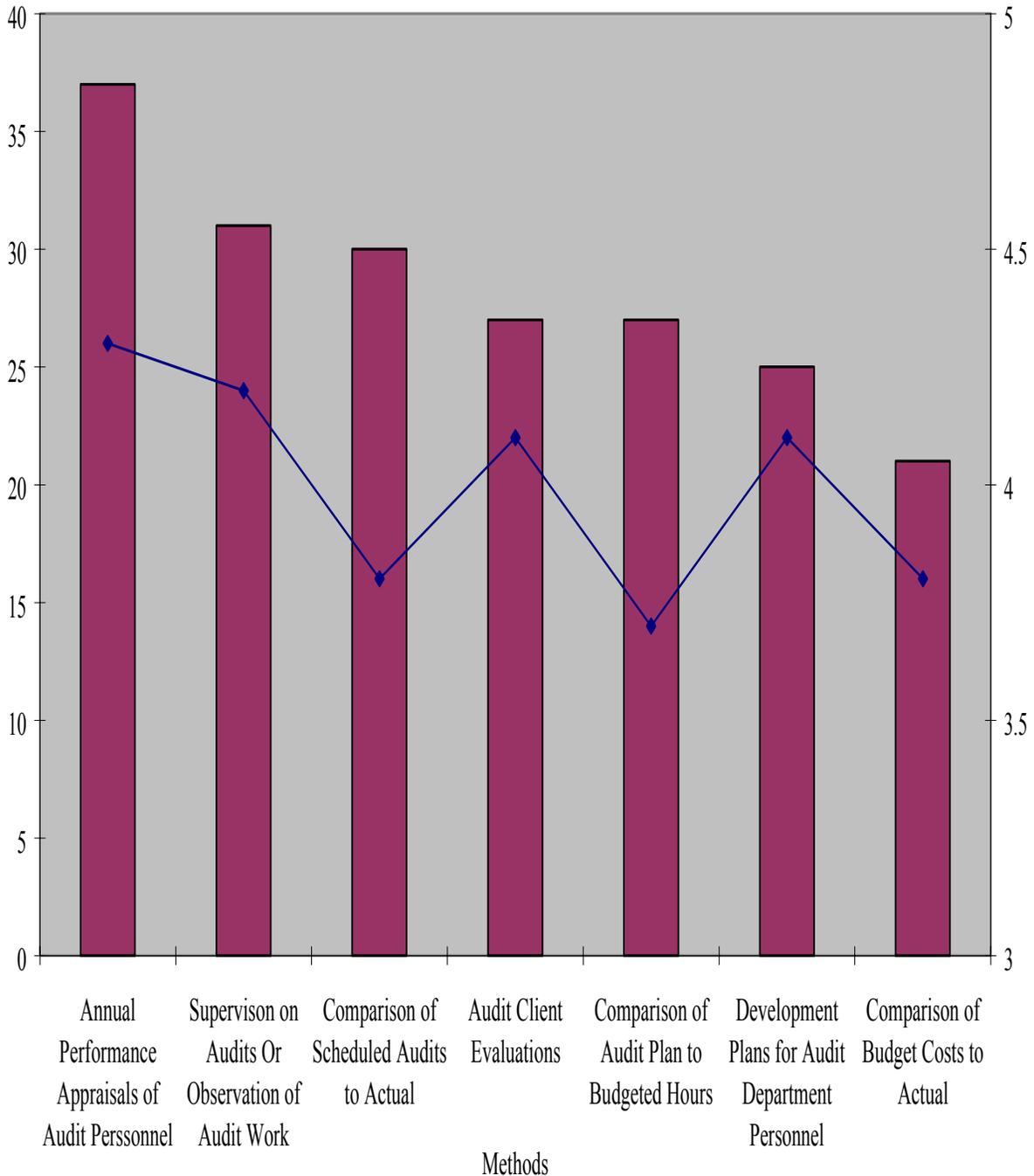
4.a. **Who influences the need for change or process improvement within your audit department (check all that apply)?**

4.b. **Do you agree that each source is highly influential in changing processes within the audit department? Rate your degree of agreement regardless of your answer(s) in part 'a'.**

The top sources influencing change were Audit Management (85%), Audit Staff and Executive Management (79% each), and Audit Client Feedback and the Audit Committee (65% each). Professional Organizations were selected as a source by 46% of the respondents. Other sources identified by survey participants included External Auditors/Regulators/Examiners.

The bars in the chart below show the level of agreement for each source of influence (listed on the left of the chart). The numbers at the end of each bar represent the number of respondents, per level of agreement and source.
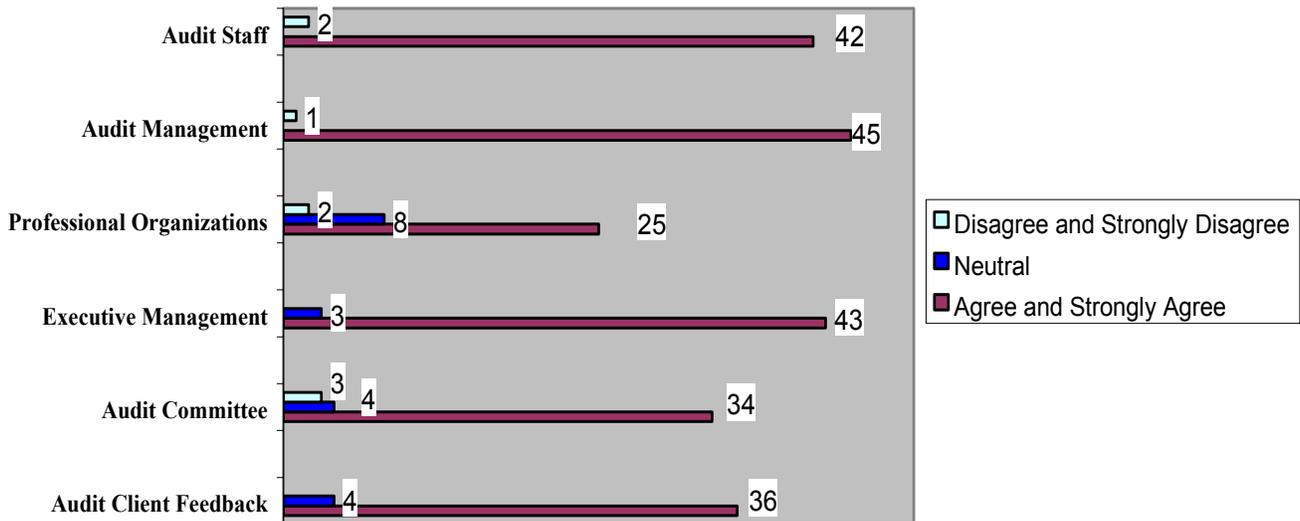
Audit Management was seen as the most influential followed by Executive Management and Audit Staff. Among respondents, Professional Organizations appear to have the least amount of influence on process changes.

5.a.   Who do you consider your audit client (check all that apply)?

Response	Number of Responses	Percentage of Total
Executive Management	45	94%
Operations Management	42	88%
Audit Committee	40	83%
Other	10	21%

The responses provided in the "Other" category really could have been classified as Operations or Executive Management, which would increase these percentages. While 83% of respondents indicated the Audit Committee was a client, we were surprised this percentage was not higher. In September 1998, the Chairman of the Securities and Exchange Commission established the *"Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees"*. The recommendations of the Blue Ribbon Committee significantly increased the responsibilities of Audit Committee members. As such, we would expect this to also have a significant impact on internal audit departments including the services they provide, who they view as their client and how they measure effectiveness of performance.

5.b.   If you 'checked' more than one item in part 'a', please explain how you satisfy the needs of the differing constituents (i.e., issuing multiple audit reports, write executive summaries)?

Respondents were asked to write in their responses, which are summarized in the table below.

Response	# Responses
Use different types of projects and reports to satisfy different clients needs	**10**
Executive Summaries in addition to the detailed audit report	**21**
Issue the same report to everyone	1
No response provided	10
Audits cover both financial and operational issues	2
Quarterly meetings with Executive Management and Audit Committee	2
Audit plans address management's area of concern	2
Audit reports	4
Quarterly and/or yearly summaries	1
Attend department meetings and employee orientation	1
Communicate overdue and repeat audit findings	1
Don't understand the question	1

The most frequently received response was the use of an executive summary. Ten respondents indicated that they perform different types of services and issue different report formats to appeal to the needs of the specific client.

6.a.   Your audit clients accept ownership of internal control (check best answer).

Each bar in the graph below summarizes the responses to this question by the indicated agreement level as shown in the legend (to the right of the graph). The numbers on the top of each bar represent the number of responses received per level of agreement.
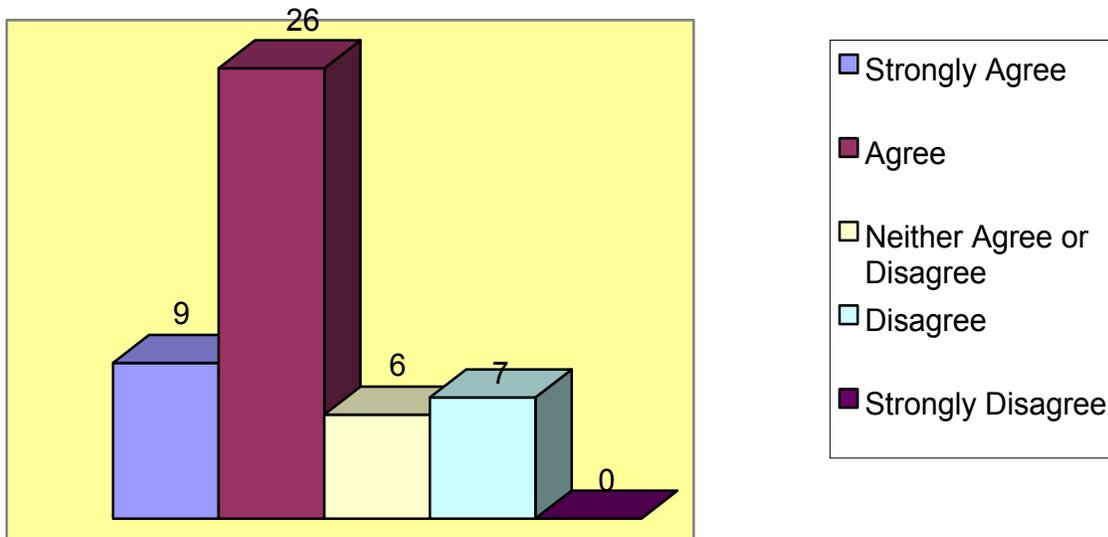
As illustrated in the graph, most respondents (73% Strongly Agreed or Agreed) believe their clients accept ownership of internal control. In questions '2.a.' and '2.b.' we asked respondents if their measures included the activities listed in the table below.

Activity Measured	# who measure	Strongly Agree	Agree	Neither Agree or Disagree	Disagree	Strongly Disagree
Improved control ratings in areas reviewed	11	3	19	6	8	1
Degree of implementation of audit recommendations	17	15	12	5	4	1

While we did not survey members as to why they measure an activity, perhaps the activities listed in the table are measured in an attempt to determine ownership.

6.b.   What helped influence (or prevented, based on your answer in '6.a.') client ownership of internal controls and how do you measure ownership?

Respondents wrote in their responses to this question. The table below summarizes all of the responses received.

Response	Number of Responses
Strong management acceptance of responsibility for controls within their areas of responsibility. Clear delegation of authority and assignment of responsibilities.	8
Continuous monitoring, auditing, identification of risk and reporting.	4
Implementation of CSA methodology.	3
Close working relationship with audit. We have continued to instill this belief with operating management. Also, this belief is presented in current literature and business practices.	1
Tone at the top; Corporate structure.	6
Company procedure guides and compensation factors influence client ownership of the controls.	1
Oversight by audit committee/board of directors. Responsiveness to audit findings, initiative in implementing controls.	1
Training on internal controls, and management commitment to internal controls.	1
Prevented:	
Executive Management is the biggest hindrance of client ownership of controls.	1
The lack of accountability has often prevented ownership of internal controls and that varies by department.	7
Audit clients perceive controls as belonging to Internal Audit and providing limited benefit to them. Lack of upper mgmt. buy-in to champion controls and lack of accountability and consequences when controls break down	4
Measure:	
Departmental audits of internal controls.	1
Client ownership is measured when recommendations are implemented.	1
Monitor on monthly basis considerable issues, on semi-annual basis notable issues, and then perform follow-up on all issues when new review is performed.	1
By their agreement to risk exposures identified and commitment to mitigate or manage risks	1

7.a. Your department affects behavior modification within your organization (check best answer)?
7.b. Please explain your answer to part 'a'.

The graph below summarizes the responses received to part 'a'. The bars indicate the level of agreement in response to the question (per the legend to the right of the graph). The numbers at the top of each bar indicate the number of respondents per each level of agreement. The graph illustrates that a large number (40 out of 48, or 83%) of respondents believe their department affects behavior modification within the organization.
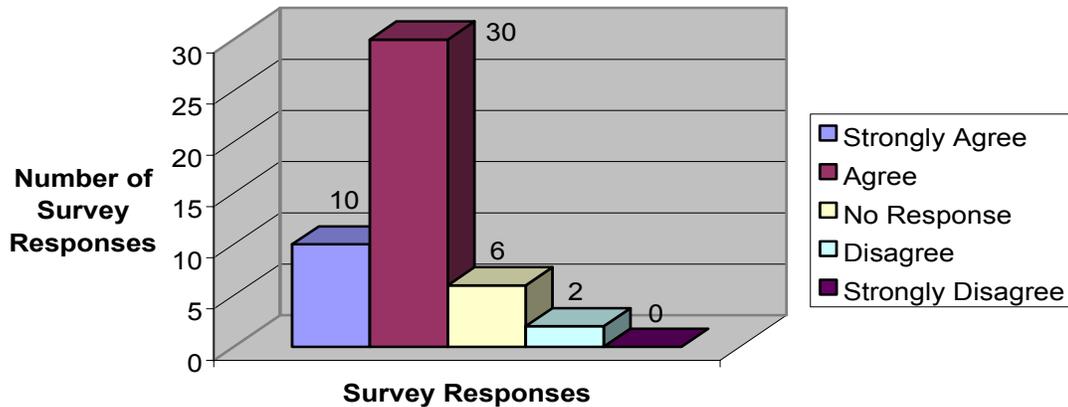
Responses received for part 'b' are summarized in the table below.

Response	Number of Responses
We work closely with operating management and senior management. Over the years, we have demonstrated our ability to enhance operations and thus earned respect and support of the management team.	4
By providing clear and concise reporting of meaningful issues.	9
Through promoting who owns the control environment and with assisting to put processes in place to monitor controls.	1
We provide a structured method of analyzing risk to the company.	5
We make recommendations, Executive management agrees, the organization implements.	5
People respect our office and staff and know that we are carrying the voice of and have the backing of executive management.	2

Response	Number of Responses
CSA helps broaden understanding of business objectives, controls, risks and decisions to accept risk or responsibility for mitigating risk. Significant corrective action may modify process and people behavior. Fraud reporting awareness and individual ethics responsibility education.	1
Most people are interested in improving operations if the budget allows it to happen.	1
Sometimes we do, other times, it is not cost effective to change.	1
Disagree:	
Some influential senior managers actively work to limit internal audit's input and influence. They see audit as a necessary evil that will prevent them from implementing their strategic plans if involved in project development	1

8. **The following items significantly influence your audit client's level of satisfaction with internal audit?**

- 96% (46 / 48) strongly agreed or agreed that underlined interpersonal skills of the audit staff significantly influenced the clients level of satisfaction.

- 92% (44 / 48) strongly agreed or agreed that language used in audit reports and other formal communications significantly influenced the clients level of satisfaction.

- 88% (42 / 48) strongly agreed or agreed that content of formal communications/presentations significantly influenced the clients level of satisfaction.

- 81% (39 / 48) strongly agreed or agreed that presentation format of communicating audit results significantly influenced the clients level of satisfaction.

- 79% (38 / 48) strongly agreed or agreed that the efficiency of the audit department in performing the engagements significantly influenced the clients level of satisfaction.

- 54% (25 / 46) strongly agreed or agreed that the control ratings issued in conjunction with audits significantly influenced the clients level of satisfaction. 28% (13 of 46) neither agreed nor disagreed.

- 54% (26 / 48) strongly agreed or agreed that timely response to requests for audit services significantly influenced the clients level of satisfaction.

9. **Who do you share the results of audit department appraisals or performance measurements with (check all that apply)?**

- 33% (16) respondents did not share the results of the audit departments appraisals or performance measurements.

- 67% (32) respondents do share the results of the audit departments appraisals or performance measurements. The top responses included:
  - ➢ 41% (13 of the 32) share the results with both the Audit Committee and Executive Management.
  - ➢ 16% (5 of 32) share the results with the Audit Committee only.

> ➢ 13% (4 of 32) share the results with the Audit Committee, Executive Management, Operations Management and External Auditors/Regulatory Bodies.

10. Are you familiar with the IIA sponsored service "Global Auditing Information Network" (GAIN)?

- 58% (28) of the respondents were familiar with the "Global Auditing Information Network" (GAIN), an IIA sponsored service.

- 42% (20) of the respondents were unfamiliar with the "Global Auditing Information Network" (GAIN), an IIA sponsored service.

Audit Department Management
Dallas Chapter IIA
Appendix A -- Survey and Results

Section A: Demographic Information

1. Your IIA Chapter affiliation:

Response	Number of Responses
Dallas	52
Fort Worth	2
Other (Specify)	0
Does not apply	0
Total Responses	54

2. Your title:

Response	Number of Responses
Vice President (combined with Manager)	8
Supervisor	3
Manager	16
Director	19
Other (Specify)	
General Auditor (combined with Director)	2
Assistant Auditor (combined with Staff)	1
Senior IS Auditor (combined with Staff)	1
Senior (combined with Staff)	2
Assistant Vice President (combined with Supervisor)	1
IS Auditor (combined with Staff)	1
Total Responses	54

3. Your organization's industry (check one that applies most):

Response	Number of Responses
Accounting/Legal/Consulting (Other)	1
Agriculture	0
Banking (Banking & Financial Services)	5
Computer/Data Processing Services (Technology)	5
Education (Other)	1
Energy (oil & gas)	4
Government (Other)	2
Health Care	4
Manufacturing	7

Response	Number of Responses
Non-Bank Financial Services including Insurance (Banking & Financial Services)	6
Not-for-Profit	0
Real Estate/Construction (Other)	2
Transportation	4
Utilities (Other)	2
Wholesale or Retail	6
Other (Specify)	
Energy Projects Worldwide (Energy)	1
Telecommunications (Technology)	2
Hotel Management/Hospitality (Other)	2
Total Responses	54

4. Number of employees in your organization:

Response	Number of Responses
Less than 50 (Small)	1
51 to 250 (Small)	1
251 to 500 (Small)	1
501 to 1,000 (Small)	1
1,001 to 5,000 (Medium)	11
5,001 to 10,000 (Medium - Large)	6
More than 10,000 (Large)	32
Total Responses	53

5. Number of auditors in your department:

Response	Number of Responses
Less than 10 (Small)	25
11 to 20 (Small)	7
21 to 30 (Medium)	5
31 to 50 (Medium)	3
51 to 100 (Large)	0
More than 100 (Large)	14
Total Responses	54

6. Average number of years experience of audit staff:

Response	Number of Responses
Less than 2 years	3
2 to 5 years	7
6 to 10 years	31
More than 10 years	12
Total Responses	53

Section B: Audit Standards and Management Objectives (questions and responses included in the body of the report)

Section C: Audit Department Administration (questions and responses included in the body of the report)

Section D: Appraising the Internal Audit Function

1. Your department performance metrics are based on which of the following: (check all that apply)

    Responses were provided in body of the report. However, other responses included: Strategic objectives (the other responses was revised from 3 to 2 and this response was moved to Audit Department Management Expectations which increased from 30 to 31) and value added to the organization & cost recoveries/potential savings.

2.a. Do your performance measures include any of the elements listed below (check all that apply)?
2.b. Do you agree that these elements are effective measures of audit department performance? Rate your degree of agreement regardless of your answer(s) in part 'a'.

Element	Currently Applies	Strongly Agree	Agree	Neither A or D	Disagree	Strongly Disagree
Completion and thoroughness of the annual risk analysis (risk assessment) process	24	9	24	8	0	0
Percentage of audit plan time allocated proactive versus reactive audit engagements	13	2	12	12	11	0
Completion of the audit plan within budgeted hours	21	2	23	5	7	2
Completion of the audit plan within budgeted dollars	16	1	22	9	6	2
Chargeable hours of audit staff (audit time allocation)	17	4	16	9	7	2
Length of time required to complete a project	25	4	22	5	7	2
Completion and thoroughness of engagement planning	9	6	20	11	3	0
Rate of change in reported fraudulent activity	3	2	6	11	11	6
Number of frauds identified through routine audits	1	1	4	11	12	7
Number of reports issued	16	5	8	4	14	7

Element	Currently Applies	Strongly Agree	Agree	Neither A or D	Disagree	Strongly Disagree
Timeliness of report issuance	22	11	24	4	0	1
Relevance of issued reports	23	21	13	6	0	0
Number of deficiencies identified in audit work	1	1	4	6	17	6
Type of deficiencies noted in the audit report	9	2	14	13	8	2
Improved control ratings in areas reviewed	11	3	19	6	8	1
Timely responses to audit reports	14	6	14	8	6	2
Degree of implementation of audit recommendations	17	15	12	5	4	1
Cost savings provided to the organization as a result of implementing audit recommendations	18	12	14	7	5	2
Audit client satisfaction	28	11	23	8	0	1
Number of management requests for audit services	14	10	17	7	4	2
Number of audit staff promoted to management positions within your organization	4	3	8	10	11	3
Rate of turnover in the audit department	10	2	12	10	10	2
Other:	38	17	12	2	0	1

Other responses included: audit cost to revenue, audit cost to company assets, staff professionalism, billable hours, years of experience of staff, coverage based on degree of risk, empowerment of audit staff, training hours per auditor, audit staff meeting their training plan, certifications of audit staff, money saved/recovered, job satisfaction of audit staff, value added to the organization, amount of unsatisfactory ratings, annual effectiveness rating of the organization, and the types of audits completed.   Billable hours was rated as "Strongly Disagree" as an effective measure. Percentage of Staff Attaining Their Training Plan and Average Total Years of Staff Experience were rated as "Neither Agree Or Disagree" as an effective measure. All "Other" responses were rated as either "Strongly Agree" or "Agree" on effectiveness.

3.a. What methods do you utilize to measure performance (check all that apply)?
3.b. Do you agree that these are effective measures of performance? Rate your degree of agreement regardless of your answer(s) in part 'a'.

Element	Currently Applies	Strongly Agree	Agree	Neither A or D	Disagree	Strongly Disagree
Comparison of audit plan to budgeted hours	27	4	25	6	4	1
Comparison of budgeted costs to actual expenses	21	9	17	7	4	1
Comparison of scheduled audits to actual	30	7	25	8	3	0
Time management software for monitoring staff productivity	15	7	14	8	4	2
Project management software for measuring project	3	3	12	15	3	0
Software to capture data such as number of reports issued, control ratings, incidence of fraud, cost savings, etc.	13	8	13	11	2	0
Audit client evaluations	27	12	23	5	1	0
Self-evaluations performed by staff at the conclusion of an engagement	8	0	18	15	4	0
Quality assurance (peer) reviews	12	5	19	9	3	0
TQM or work group reviews	1	1	9	19	3	2
Audit committee evaluations	9	10	17	5	3	0
Benchmarking with other departments	15	7	17	10	1	1
Supervision on audits or personal observation of audit work.	31	18	20	2	2	1
Development plans for audit personnel	25	15	18	8	1	0
Annual performance appraisals of audit department personnel	37	17	26	3	0	0
Other:	10	4	5	1	0	0

Other responses included agreement with recommendations, resolution of significant issues, employee satisfaction surveys, quarterly performance appraisals, effective communication, corrective action implemented, disputed findings, and working independently. All of these were rated as "Strongly Agree" or "Agree" as effective means with the exception of employee satisfaction survey, which was not rated. One "Other" response that was not described was rated as "Neither Agree or Disagree".

The questions and responses for the remaining questions in Section D are included in the body of the report.

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Tongren – Tongren, John D., "Integrated IT Audit – Part I", March 1, 1999, http://www.itaudit.org/public_forum/f205ac.htm.

Zhang – Zhang, Charles, "A Check-up for Your Charter", <u>Internal Auditor</u>, October 1999, Pages 42-43.

Additional Research
(Utilized for survey development)

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Lione – Lione, Susan B., "Exposure Draft Code of Ethics", <u>Internal Auditor</u>, October 1999, Page 76-77.

"Internal Audit Best Practices Defined", <u>Internal Auditor</u>, February 1999, Pages 11-15.

Sowerby – Sowerby, Fay M., "Courting the Crème de la Crème", <u>Internal Auditor</u>, April 1999, Pages 19-20.

"The Internal Audit Profession – Redefined", <u>Internal Auditor</u>, August 1999, Page 11-17.

Lynn Allsup, CFSA, CPA – This is Lynn's fourth year on the Research Committee. In 1999, she was the Research Committee Chair. Lynn is an Operational Audit Director at Winterthur Swiss Insurance, where she is responsible for managing audits of insurance subsidiaries in North America. Prior to this, she held positions of increasing responsibility at KPMG Peat Marwick. Lynn earned her MBA from The University of Texas at Arlington and her BS degree from Oklahoma State University.

Ruth Burton, CISA – This is Ruth's first year to serve on the Research Committee and first time to Chair. Ruth is responsible for planning and reporting activities for The Associates' Corporate Audit Department and has eight years of audit experience in consumer lending and loan servicing. Ruth has a BS in Accounting Control Systems from The University of North Texas.

Mary Beth Goodrich, CIA, CPA – This is Mary Beth's third year on the Research Committee. In 1998, she was the Research Committee Co-Chair. Mary Beth is currently in The Associates' Corporate Audit Department and is responsible for leading and conducting Risk Assessments, Audits, and Special Projects for Corporate, Technology, and Insurance functions. Prior to The Associates, she was an Advanced Auditor at EDS. Mary Beth earned her MBA with a specialization in Internal Audit from Louisiana State University (LSU) and her BS degree from McNeese State University. She currently serves on LSU's Internal Audit Advisory Board.

Tarazeta Huntley – This is Tarazeta's first year on the Research Committee and membership in the Chapter. Currently, she is an Audit Director for The Associates' Consumer Centralized Audit Team and is responsible for managing Audits, Risk Assessments, and Special Projects. Prior to that, Tarazeta worked for The Associates for seven years with a background in management and process design for a centralized servicing operation. Tarazeta earned her BS degree in Accounting from The University of Texas at Arlington.

Marilyn Kapral, CPA – This is Marilyn's second year to serve on the Research Committee. Marilyn utilizes her healthcare and financial background as an Operational and Compliance Auditor for University of Texas Southwestern Medical School. Previous auditing and accounting positions include Presbyterian Healthcare System, Texas Health Resources and Dallas County. Marilyn earned her MS in Management and Administrative Sciences from University of Texas at Dallas, an MA from the University of Texas at Austin and BS from Kansas State University.

Steve Lantrip, CISA – Steve has been a member of the Research Committee since 1995. He has over twenty-five years of diversified audit experience. Currently, he is a Senior Auditor for the Army Air Force Exchange Service and performs worldwide audits, with particular focus on advanced information technology (IT) audits. He develops and instructs non-IT auditors on IT basics. Prior to that, Steve assisted in originating the IT audit function at Zale Corp. Steve has his BBA degree from The University of Texas at Austin. He helped start the North Texas Chapter of the EDPAA, which is now the Information Systems Audit and Control Association and is a current member of The Institute of Internal Auditors.

Bob McCall, CIA, CISA – Bob assisted the Research Committee in programming the survey for use via the Internet and is an honorary member of the Research Committee for his hard work and efforts. He is currently a Senior Project Manager in JCPenney's Internal Audit Department. Bob

began his career with JCPenney in Store Merchandise Management. Within Auditing, he has worked in several areas such as Store/Field Auditing, Merchandising Auditing, Training & Development, Store Systems Auditing and Store Systems Implementation. He assumed his current responsibilities as the Manager of the Dallas Store Audit Staff in September 1998 and will be transferring to Clearwater, Florida in May 2000 to audit JCPenney's subsidiary, Eckerd Drugs. Bob is a graduate of Temple University in Philadelphia and has a BA in Communications.

Jeffery Seutter, CIA – This is Jeff's first year as a member of the Research Committee. Jeff is a Corporate Auditor for the Commercial Division of The Associates. Jeff's primary responsibilities are the leading and conducting of Risk Assessments and Audits for the Centralized Commercial functions. Before joining The Associates, Jeff held positions within the Internal Audit and Controller's functions of JCPenney. Jeff is currently the chair of the Programs Committee for the Dallas IIA chapter and has served twice as the chapters' chair for the Academic Relations Committee. Jeff has a BBA with a specialization in Finance from the University of North Texas.