Tennessee Department of Transportation

Division of Internal Audit
Performance Audit Desk Guide

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Audit Project Management and Audit Process Flow

Generic Outline
Performance-Operational Audit

The following audit program provides suggested steps to enable a moderately experienced auditor to complete a performance/operational audit and meet the required yellow book standards. It is important for the auditor to recognize that the suggested steps are shells to help internal auditors develop their engagements-specific procedures when performing a performance/operational audit.

The processes enumerated herein should be utilized in conjunction with the internal audit how-to- guides as well as the internal audit policies and procedures manual. Auditors can utilize other available practice aids for particular areas in the fieldwork phase as necessary.

AUDIT PROGRAM PURPOSE AND SCOPE

This program has the following major points:

- Provides a general engagement project management guide
- Enables the auditor to understand the nature the organization's objectives
- Facilitates understanding of the organization's various operations
- Aids in performing preliminary analytical procedures and evaluating the results
- Helps Identify relevant operational risk factors
- Helps in Identifying significant compliance requirements
- Developing the risk register and documenting the internal control assessment
- Refining and developing granular audit objectives
- Facilitates the design of the testing protocol(s)
- Guides the auditor in interpreting and summarizing results
- Provides the appropriate sequence for reporting the outcome of the engagement

I. **Preplanning/Pre-Engagement Activities -** are audit engagement activities that an auditor may perform even before the Director formally announces the engagement. These activities normally include obtaining internal and external information regarding the subject matter of the audit.

Purpose: The purpose of this procedure step is to gain a general knowledge of the operation under audit

Objective and Goal(s): The objective of this procedure step is to prepare project management documents, ensure project independence status, and conduct a preliminary information gathering about the subject matter of the audit.

AUDIT CHECKLIST

	What to do:	Check-off	References
1	Create an **Entrance Conference Agenda** using the standard format located in the internal audit library.		
2	Submit the entrance conference agenda to either the audit director or the principal auditor for review and approval.		
3	Assess auditor independence using the GAGAS conceptual framework for independence; note any potential independence threats and notify the audit director. If no issues arise after evaluating auditor independence, proceed to the next steps.		
4	Prepare other project management documents such as project independent statements (do not date), budget (discuss with Director), protection of confidential information statements, sign-off status worksheets, questionnaires (if any), surveys (if any), and Fraud Risk Assessment forms.		

	What to do:	Check-off	References
5	**Conduct a background information search** using the Internet or other internal organizational sources; the purpose of this step is to obtain a broad knowledge of the subject of the audit. **Several things that you would want to gain an understanding of:** • What is the nature of the auditee's operation • What is the primary objective of its existence • What product(s) or service(s) do they deliver • Can you ascertain the source of funding • Are there published budgets, revenues, and expenditures for this organization • Do they have published operating standards or reports • Has there been any news regarding this function on the Internet? If so, what were the issues pertinent that became newsworthy • What do others in the same industry perform? How similar or different is this from the auditees operation **Your potential information sources of information may include:** • Internet and Intranet • Legislative rules, relevant legislation (new), and federal regulations • State policies and procedures • Entity rules and regulations • Entity manuals, field guides, desk guides, and P&P manuals • Prior audits from other State Comptroller and other DOTs • Libraries or Permanent Records • Trade or Industry Journals • Published reports from Consultant Firms When reviewing audit reports, note what issues were prevalent during these engagements. If the audit pertains directly to your auditee, note the issues that were mentioned and inquire about its status when you have the opportunity. If this is an audit that was conducted on an entity that has a similar function to your auditee, also note the issues that were encountered by the auditors because there is a high likelihood that similar issues may arise (given the similar activities) in your audit.		
7	**Perform a final review of the background material to become familiar with the activities of the organization.**		
6	Compile the preliminary information that you have obtained and note any significant items that you may have observed from your pre-engagement activities.		

Reminder: did you perform the following?

- **Prepare the necessary forms**
- **Obtain sufficient information about the audit subject matter to gain a general knowledge about their activities**

Output(s):

- Project management documents
- External and industry information about the audit subject matter
- Entrance conference agenda
- Information requests list

II. **Planning Activities -** are audit engagement activities that an auditor performs after the entrance conference. These activities normally include obtaining internal/operational and some external information regarding the subject matter of the audit. In this step, the auditors may also utilize surveys, questionnaires, and group meetings with organization personnel to gain an understanding of transactional process flows, existing internal controls, process inputs and outputs, exceptions, issues (both existing and impending), and performance metrics.

In this section, the auditors also discuss the entity's activities from an operational standpoint noting any changes in the policy and procedures, employee turnover rate, and operational constraints**.**

Purpose: To gain a **working knowledge** of the operation under audit

Objective(s) and Goals: The objective of this procedure step is to gather pertinent information regarding the audit subject matter. This is a more formalized approach then the scoping conducted during the preplanning stage. In order to comply with auditing standards, the auditor must demonstrate an understanding of the audit subject matter especially as they pertain to, **(a)** key activities performed, **(b)** organizational structure **(c)** financial flow resources, **(d)** regulations policies and procedures they need to follow, **(e)** key computer applications they use, and **(f)** the general workflow within the various business operations.

AUDIT CHECKLIST

	What to do:	**Check-off**	**References**

1	Obtain an organizational chart and gain an understanding of the various activities performed by the auditee. Within this area, there are several things that we need to understand and that includes the following:
	
	• The risks inherent to the operation
	• The key controls needed to counter those inherent risks and influential environmental aspects
	• We need to learn about the management of the operation (management style and level of control)
	• We need to understand how the organization conducts its **planning**, **directing**, and **controlling** activities
	• How does management find out about the work environment
	• Does management have specific concerns about any area within their purview
	• Learn about the people performing the activities/operation
	
	    ➢ Key personnel and their roles within the entity
	    ➢ Are there written job descriptions for the staff
	    ➢ What kind of staff training is given
	    ➢ What methods does management use to evaluate staff
	    -		

	What to do:	Check-off	References
2	Obtain financial information (management summaries, year-end reports, balance sheets, revenues and expenditure, and cash flow statements) regarding activities performed by the auditee.		
3	Gain an understanding of the auditees financial flow resources. The critical element in this exercise is to ascertain both the inflow and the outflow of monies. The auditor should endeavor to understand the following: • Does the unit or activity generate revenue • What are the unit's source(s) of revenue • In what form are revenues received (cash, checks, credit cards, electronic funds transfer, inter-agency transfers, etc.) • Do they have a budget • What are the unit's expenditures • What are the current trends of their finances (perform a horizontal and vertical analysis)		
4	Gain an understanding of the auditees overall business operations by ascertaining the following: • What are the unit's Mission and Vision statements • Where do their inputs come from • Who depends on the unit's output • Are there any time or seasonal constraints • Are there geographical constraints • Are there monetary constraints • What are the current trends for the operation (staff turnover, work volumes, major organizational changes, etc.) • Does the business unit have a formal business plan • Does the business unit have a business recovery plan • Does the business unit have standard operating procedures or policies and procedures manuals • How does the organization set its priorities • What performance measures or indicators does the unit utilize to measure success		
5	Ask management if they are aware of any historic or current instances of fraud, waste, or abuse within their area of responsibility.		
6	Develop a questionnaire for interviews and discussions. Arrange for the initial meeting (set a cooperative, but no-nonsense atmosphere) and facilitate an open-ended discussion allowing the interviewee to discuss their own work processes. Note the following: • Interview people involved in key activities of the operation • The interview should include a process walk-through of that person's job tasks • Allow the interviewee to explain their workflow by asking them the		

	What to do:	Check-off	References
	question," How the work move into and out of your desk?" (area of responsibility) • Try to be sufficiently transparent by allowing the interviewee to demonstrate the actual process of an activity from input through the final output • Inquire about exceptions and how are they handled • Ask the interviewee who performs the work in their absence • Obtain example documents and/or copies of outputs • **If necessary, obtain access to files worksheets and databases containing audit information** • **If necessary, obtain copies of worksheets and databases (you may need this to conduct preliminary analytical procedures)** • Note how the process of this key individual contributes to meeting the overall objectives of the organization During this time, it is imperative that the auditor note any inconsistencies between the stated and observed procedures. In addition, the auditor must note any observed internal control issues such as *inadequate segregation of incompatible duties*, *lack of supervisory review*, *reconciliations not performed*, *inaccuracies in input information*, *inaccuracies in output information, management overrides*, and *other potential internal control issues*.		
7	When you have developed a good picture of the entire process flow and all those who are involved in the process, document your understanding by creating a process flow narrative or creating a flowchart visualization of the process. It is essential that we document the process flow as we have observed it and not as it is supposed to be. This is the only way that we can ascertain whether a variance exists between the expected and the actual outcome. Once a process flowchart is complete, present it to the client and walk them through the process. If there are any discrepancies, make the necessary corrections and present the revised version to the auditee one more time. Once there is congruence between the parties, ask the auditee to acknowledge the flowchart, sign, and date the document, and provide the auditee with a copy. **Notes:** 1. Ideally, the best way to map a process flow is to have all the players present in one room while mapping the entire activity. In this way, you can receive accurate input directly from the folks that are conducting the work. However, in real-world instances, it is far more difficult to get people together to conduct this process. 2. Whenever documenting a particular process flow, note the time it takes to perform each steps as well as the time elapsed between each step.		

	What to do:	Check-off	References
	3. Understanding the process flow enables us to gain an understanding on the efficiencies (or inefficiencies) within a particular process as well as the controls that are in place. **4.** We normally use the output from this activity as an aid to develop the process risk assessment. **5.** When developing the process risk assessment we need to be aware of external factors that can influence the output, exceptions to the norm, bottlenecks, wait times, and the presence of excessive controls (because all of these contribute to process inefficiencies and opportunity costs).		
8	Perform any preliminary analytics before you begin completing the risk register. You want to do this so you have a better understanding of any transactional red flags that may exist. In performing preliminary analyses, note general statistical characteristics of the transactions as well as a summary of financial information (use ACL or Excel)		
9	Prepare a summary of the electronic data processing systems used in carrying out functions and activities (we need to take into account the importance of the information systems as they relate to our audit objectives). The summary should include information regarding application-specific controls for the electronic data processing system. **Notes:** 1. There may be numerous information systems being utilized by the unit, if so document each one of them. 2. Gain an understanding of how each information system is interrelated. 3. Gain an understanding of how the interrelation affects the inputs, processing, and output.		
10	Prepare a risk register using the guide provided in Appendix E of the P&P manual. **Notes:** Internal Control Review Identification requires a review of the controls that the auditor will rely on during detailed testing. We need to assess the following: • The description of the controls • Analysis of the controls • Evaluation of the appropriateness of the controls It is important to consider other factors that may influence your assessment of the controls. Other influences on controls include: • Accidental or deliberate avoidance of controls • Management overrides • Non-operation		

	What to do:	Check-off	References
	• Backup and recovery • Environmental impact • Formal means of communication • Access controls over data and information		
11	Schedule a process flow review, fraud assessment, and process risk assessment as required in the policies and procedures manual. Ensure that a certified member of the audit team is present. • Brainstorm (Fraud, Process efficiencies, Process deficiencies) • Discuss internal control presence, design, and implementation • Focus on possible cost savings from inefficiencies • Ascertain any areas or opportunities for potential improvements		
12	If applicable, use some of the information obtained from the external research as a basis for developing criteria for the audit. As a general practice, criteria is best when: • It comes from an objective third party • It is agreed-upon by the auditor and the auditee • It is free of subjective interpretation • It comes from an authority on the subject matter **Notes:** Criteria is the basis from which we will evaluate a given transaction, activity, function, or division. Criteria are easier when performing compliance auditing and evaluating internal controls. However, performance audit criteria may arise from laws, regulations, contracts, grant agreements, standards, benchmarking procedures, accepted or defined business or industry practices, and other performance measures.		
13	Prepare a risk register using the guide provided in Appendix E of the P&P manual. **Notes:** Internal Control Review Identification requires a review of the controls that the auditor will rely on during detailed testing. We need to assess the following: • The description of the controls • Analysis of the controls • Evaluation of the appropriateness of the controls It is important to consider other factors that may influence your assessment of the controls. Other influences on controls include: • Accidental or deliberate avoidance of controls • Management overrides • Non-operation		

	What to do:	Check-off	References
	• Backup and recovery • Environmental impact • Formal means of communication • Access controls over data and information		
14	**Set Audit Objectives** At this point, you may have to validate the original objective(s) and or refine the objectives that you have already in place. It is critical to remember that the results of the risk assessment are the primary source for developing the final audit objective(s). **Purpose:** To ensure that sufficient appropriate audit evidence will be obtained **Criteria** - what will we use to judge the operation, activity, process, or function (eg. policy manuals, laws, professional standards, public opinion, etc.) **Cause** - what are the reasons for the differences between the criteria (should) and what the auditor found (is)? **Effect** - what is the result or impact of this difference between the criteria and findings? **TDOT Internal Audit frames audit objectives as a question** **Example:** Did consultants purchase paper in bulk in excess **(cause)** of actual and current needs **(criteria)** thereby increasing storage and other costs **(effect)**? **Note:** These objectives will not be the same as operating objectives and will not always follow the SMART formula (i.e. Specific, Measurable, Attainable, Result orientated, and Time bound). They will be concerned with whether the auditee meets operating objectives.		
15	**Set Scope** **Purpose:** to manage expectations on what the audit plans to achieve (and to prevent cold creep) we set the boundaries of what will and will not be included in the engagement. Your tasks as an auditor are to review and update if necessary the scope of the audit. You need to ensure that you communicate any changes to all concerned (with auditee management and the audit team). **Remember that during the planning phase your responsibility is to establish a cooperative relationship with the client and conduct the**		

	What to do:	Check-off	References
	work in a participative audit style. Setting the scope allows us to do the following: • Develop a plan for the audit. • Plan audit resources & expertise required • Timing of the Audit • Define Audit tests & the use Computer Automated Audit Tools (CAATs) • Device the final Audit Program • identify risks to the audit itself • Define Major audit milestones Work with the chief audit executive to finalize the scope of the audit engagement.		
16	Once you have defined your final audit objectives, you will need to proceed with completing the **Planning Memorandum**. Remember that the planning memorandum summarizes all that you have learned regarding the audit subject matter. Once completed, present the **Planning Memorandum** to the chief audit executive for review.		
17	Once your **Planning Memorandum** has been approved, arrange another meeting with audit management to collaboratively develop a program step for each area of your scope. You will then work with the chief audit executive to devise a specific audit plan and procedures to answer the audit objective question(s). In this process, we will summarize requirements for testing and how we will evaluate internal controls. The testing plan will also include defined sampling plans as well as definitions for what constitutes an exception.		
18	Add the information from this meeting and defined audit procedure steps to the planning memorandum and within ACL GRC.		
19	At this point in the audit, you will need to provide an updated budget time and a revised project budget request. Normally, to get a good assessment of how long fieldwork would take, you would've done a pilot test on one transaction and accounted for how long it took to accomplish you would then multiply this by the number of transactions you wish to test (as defined in the sampling and testing plan). Divide the total hours by the number of days to arrive at an estimated date of completion.		
20	Once the planning phase is complete, you will need to arrange a meeting with the auditee to discuss the planned approach.		

	What to do:	Check-off	References
	The auditee needs to understand that you plan to provide continuous communication on any identified observations. Remind them that if you have observed critical issues that require their immediate attention, you will notify them immediately and not wait for the observation sheet or draft report.		

Tips: to make the best use of your time, you should be preparing the planning memorandum as you gather your information this way as you documented within ACL GRC you are cutting and pasting the information into sections of your planning memorandum. You will find that if you compose your planning memorandum and even your final report, as you move along, you are accomplishing multiple tasks in a very efficient manner.

Output(s): (not in any order)

- Organizational Charts
- Financial Information
- Financial Flow of Resources
- Activity-specific Information Systems (List or Summary)
- Interview and Walk-through Documentations
- Process flow Narratives or Diagrams
- Risk register/Process risk assessments
- A completed fraud questionnaire
- Fraud brainstorming session documentation
- Planning memorandum

III.   Execution (Fieldwork) - Detailed testing

Purpose: The purpose of audit testing is to carry out sufficient procedures to determine (a) compliance, (b) transactional integrity, (c) accuracy, (d) completeness, and (e) validity regarding any activity. The goal of the auditor is to obtain sufficient substantive data to provide an answer to the audit objective(s). Testing allows the auditor to collect sufficient appropriate audit evidence to be able to conclude with ***reasonable assurance*** whether the activities are working well or not.

The testing procedures are aimed at significant controls that have previously been assessed as adequate, to evaluate their effectiveness and those controls assessed as inadequate to verify that the required results are not being consistently achieved.

To validate the veracity of certain activities, transactions, and functions we utilize a variety of verification techniques. Our testing protocol or design should endeavor to verify using multiple procedures. Using multiple verification techniques enhances the audit evidence. The typical verification techniques that we use include:

- Observation
- Inquiry
- Confirmation
- Inspection
- Transaction Testing and Analysis
- Re-performance
- Comparisons
- Vouching and Tracing

It is important that we accurately assess the **CAUSE** and **EFFECT** of findings and not to make assumptions based on our subjective interpretation – the key test arises from the question:

"Would a reasonably knowledgeable auditor be able to re-perform the work and come up with the same conclusion?"

AUDIT CHECKLIST

	What to do:	Check-off	References
1	Perform the audit procedure steps as defined within the audit plan		
2	Note any issues, findings, and observations using the predefined definition of what constitutes an exception		
3	Depending on the severity of the finding or the observation, arrange a meeting with the chief audit executive to discuss the findings/observations. If an item's impact is severe, bring this to your manager's attention right away otherwise, complete the testing protocols and compile the issues noted.		

	What to do:	Check-off	References
4	Complete audit tests and write up management comments/findings and observations identified during testing. Prepare a separate **Observation Sheet.**		
5	Arrange a final meeting with the chief audit executive and the audit manager to discuss the observation sheets. The objective here is to ensure that accurate testing supports the observations and that we have exhausted all avenues of inquiry to ensure that this is a valid exception. Do not present a finding to the auditee that has not been reviewed by audit management.		
6	Based on the results of the final meeting with audit management, you may have to modify the observation sheet. Once a final observation sheet has been developed, set up a meeting with your auditee to discuss the issues noted. At this point in the audit, you will still give the auditee an opportunity to respond to the observations noted. In some cases, the auditee may have additional information that we did not have to validate unobserved exception. If the auditee provides information to substantially refute or explain the exceptions, then we will not incorporate this observation in the draft report.		
	Once you have a verified observation sheet, complete your work and close out the fieldwork activities within ACL GRC. **Remember that:** Work papers should include, at a minimum, a **purpose**, **source**, **scope**, and **conclusion**. (Refer to TDOT P&P Manual)		
	Before beginning to write the draft report, ensure that all audit working papers, the audit manager, and the chief audit executive have reviewed it and signed off.		

Output(s):

- Observation Sheet

IV.   Reporting

Audit Purpose: the report has three primary purposes:

- Inform - Clearly identify the difficulties or opportunities for improvement
- Persuade - Using support for conclusions and evidence of their importance
- Results - Giving constructive and practical means of achieving the change

Characteristics of good writing:
- Objective
- Clear
- Concise
- Constructive
- Timely

AUDIT CHECKLIST

	What to do:	Check-off	References
1	Prepare the initial draft report including all elements as required by the policies and procedures manual. Reference previously issued reports to ensure that you are following the prescribed format. Once you have a draft report completed, notify the audit manager or CAE so that they may begin to conduct reviews		
2	The audit manager/principal auditor will then assign a member of the internal audit function to perform an independent cross-referencing of the report items by vouching them to the working papers.		
3	Once a verified report is developed and a final draft is in place you will need to schedule an exit conference with the auditee's management team.		
4	**Exit Conference** Prepare an exit conference agenda with the required elements as described in the internal audit policies and procedures manual. Set up a meeting with the auditee and their management team to conduct the exit conference.		
5	Complete all remaining work papers and project management items within ACL GRC ensure that you have completed every procedure step in that each procedure step has been signed off. Notify the audit manager or the chief audit executive if there are outstanding items that need to be reviewed to ensure proper close out.		
6	Complete internal quality assessment of the audit working papers		
7	Follow up with auditee to ensure that the chief audit executive receives the		

	What to do:	Check-off	References
	acknowledgment letter and management's responses and corrective action plans to the audit recommendation(s).		
8	Complete all closeout activities as required within the policies and procedures manual. Ensure that the principal auditor/audit manager and the chief audit executive have all items needed to publish the audit report.		
9	Complete the required engagement-specific auditor performance evaluations.		
10	Conduct a post audit self-assessment on the lessons you learned from this engagement. Note the things that you have done differently or think that you could have done better. Remember, you are solely responsible for developing your own craft; by continuously learning, you strive to be better at your profession with each engagement.		
11	**Congratulate yourself; you are done with this engagement. If you did a good job, expect (at the minimum) a free lunch.**		

Output(s):

- Draft Report
- Cross-Referenced Draft Report
- Exit Conference Agenda