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Operational auditing by CPA firms; Exposure draft (American Institute of Certified Public Accountants), 1980, June 18

American Institute of Certified Public Accountants. Special Committee on Operational and
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EXPOSURE DRAFT

June 18, 1980

OPERATIONAL AUDITING BY CPA FIRMS

The Report of the AICPA
Special Committee on Operational and Management Auditing

Comments should be submitted no later than September 18, 1980 to:

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OPERATIONAL AUDITING BY CPA FIRMS

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OPERATIONAL AUDITING BY CPA FIRMS

Preface

Accounting firms were making reviews* of client operations long before audits of financial statements became commonplace. However, the literature of the AICPA contains few references to and little guidance for operational auditing, the term in general use for reviews of operations. The Special Committee on Operational and Management Auditing was appointed in 1978 to research the subject and develop appropriate information for Institute members.

This report contains information on operational auditing engagements which the Special Committee believes will be of interest to practitioners. It has been prepared with the following objectives:

1. To define operational audit engagements and to provide descriptive information on engagements that may be referred to as such in an agreement on services to be rendered.

* The term "review" is used throughout this document purely in the dictionary sense, meaning "to go over or examine". It does not mean a CPA's review services as described in the AICPA's Statement on Standards for Accounting and Review Services No. 1 or Statement on Auditing Standards No. 24.

2. To describe important differences in approach	1
between operational audits and financial	2
audits.	3

When the AICPA formed the Special Committee on Opera-	4
tional and Management Auditing, with members suggested by its	5
Auditing Standards, Management Advisory Services (MAS), and	6
Federal Government Divisions, it was asked to consider ques-	7
tions such as:	8

● What is operational auditing?	9
● What are the similarities and differences	10
between an operational audit and an audit	11
of financial statements?	12
● To what extent do professional standards	13
apply to operational audits?	14
● What measurement criteria might be used in	15
operational audits?	16
● What form of report may be appropriate for	17
operational audits?	18

This document responds to these questions and tries to	19
--	----

cover, as well, the unasked questions that we, as practitioners, would want answered. The content is not intended to be authoritative, but simply to provide information that would be useful to those who wish to become more familiar with the nature of operational audits and with the role of the CPA firm that provides operational auditing services. For those operational audit engagements which would be subject to the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, issued by the United States General Accounting Office, review of that publication and the AICPA publication, Guidelines for CPA Participation in Government Audit Engagements to Evaluate Economy, Efficiency, and Program Results, would be helpful.

This document is not intended to take the place of the numerous continuing professional education courses and books that are available and that cover the subject of conducting operational audits in more detail. Nor are the concepts discussed here new. What is different is the perspective. Existing materials generally view operational auditing as an activity within a company. This document is concerned with professional responsibilities and special considerations of particular interest to those in CPA firms who undertake operational audit engagements.

* * * * *

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OPERATIONAL AUDITING BY CPA FIRMS

1. INTRODUCTION

Auditing, as practiced by independent public accountants, 1
has long been considered synonymous with an examination in 2
accordance with generally accepted auditing standards for the 3
purpose of expressing an opinion on financial statements. 4
There is, however, another kind of "auditing" that is performed 5
by internal auditors and governmental auditors as well as 6
independent public accountants. It deals primarily with the 7
economy, efficiency, and effectiveness (performance for results) 8
of an organization's operations. 9

Such "audits" have come to be known by a variety of 10
terms--operational audits, operational reviews, performance 11
audits, management audits, and so forth. Although distinctions 12
can be, and have been, drawn among some of these terms, the 13
most commonly used is "operational auditing." 14

The term "operations," as defined in Eric Kohler's 15
respected work, A Dictionary for Accountants,¹ means "the 16
activities of an enterprise, exclusive of financial 17

1. Kohler, Eric. A Dictionary for Accountants. Englewood 18
Cliffs, New Jersey: Prentice Hall, Inc., 1975. 19

transactions and those of an extraordinary character; as
production, or the rendering of service, distribution or
administration." "Operational," means pertaining to operations.

While the performance of operational audits by CPA firms
is not a new service, the Special Committee believes CPA firms
will increasingly offer or be asked to provide this service
for their private sector and government clients. The term
"operational audit" should, therefore, come to mean a specific
kind of engagement, with specific understandings about what it
would entail. The purpose of this document is to define and
describe operational audit engagements as generally performed
by independent public accountants.

From all indications, pressure for increased emphasis on
economy, efficiency, and effectiveness of operations is grow-
ing, and so, therefore, should the demand for that specific
service referred to as an operational audit. The CPA firm,
through expertise gained in the diagnostic and fact-finding
aspects of financial auditing and management advisory services,
is in an excellent position to provide operational audit
services.

To understand the need for such services it is important
to recognize the environment in which boards of directors,
elected officials, and senior management operate today. They

are being held to higher standards of accountability and responsibility for stewardship.

In such an environment, executives and managers frequently express a need for independent evaluation and advice. Though they may have no reason to believe problems exist, they are aware that an independent third party review and the resulting recommendations can be of benefit to the organization.

This publication provides information that will help practitioners to recognize the opportunities as well as the special challenges of operational auditing engagements.

Definition of Operational Audit Engagement

An operational audit engagement is a systematic review of an organization's activities (or of a stipulated segment of them) in relation to specified objectives for the purposes of (a) assessing performance, (b) identifying opportunities for improvement, and (c) developing recommendations for improvement or further action. Some of the key terms in this definition are discussed below.

Systematic Review. A systematic review refers to an orderly, planned, objective observation and comprehensive analysis of the operation(s) in question. In order to evaluate if there is adequate support for management's functions of planning, executing, and controlling, the operational

auditor's review may include the policies, activities, systems, 1
procedures, and results that are--or should be--in existence. 2
As discussed more fully in Chapter 4, an operational audit 3
requires a review of more than financial results and reports. 4

Stipulated Segment. Although an entire organization 5
could be the subject of a comprehensive operational audit, it 6
is common to restrict the systematic review to a segment of 7
the organization. The segment could represent an organization 8
unit, such as a division, plant, department or branch, or a 9
specific function of the organization, such as marketing, pro- 10
duction, data processing, or any other agreed upon aspect of 11
operations. 12

Specified Objectives. The organization's (or a stipu- 13
lated segment's) objectives generally provide a foundation 14
for the survey and subsequent analyses concerning economy, 15
efficiency, and effectiveness in reaching those objectives. 16
Therefore, those objectives need to be specified by the sponsor 17
of the operational audit engagement before the start of the 18
engagement. The party engaging the firm, which may be the 19
organization to be reviewed or a third party, may require 20
assistance in developing specified organization objectives. 21
In such instances, the practitioner may supply assistance, 22

but the responsibility for the objectives developed would rest
with the engaging party.² The effort required to define organi-
zation objectives may be of sufficient magnitude to require a
separate engagement. During the conduct of an operational
audit, questions may arise as to the appropriateness of the
specified objectives, and conflicting objectives may also emerge.
The operational audit report may address those matters whether
or not assistance was provided in determining the specified
objectives.

Purposes. Operational audit engagements are generally
performed to satisfy a combination of the three purposes cited
in the definition: assessing performance, identifying opportu-
nities for improvement, and developing recommendations for
improvement or further action. In some engagements, one of
the purposes may take precedence over the others. The varia-
tion in importance may be closely related to the objectives
of the operational audit engagement and its source.

- Assessing Performance. The findings of any opera-
tional audit, by their nature, may be viewed as
an assessment of the performance of the reviewed
organization. Assessing performance is comparing
the manner in which an organization is conducting

2. The term "client" is generally applied to the entity being
audited. Therefore, the use of that term may be confusing
in reference to an operational audit, since the engaging
party and the entity to be reviewed may not be the same.
When this distinction is important, the term "engaging
party" is used in this document.

activities to (1) criteria used by management, if 1
they exist (e.g., compliance with organization- 2
al policies, standards, goals, procedures, and 3
so forth), (2) other criteria, if they are 4
appropriate, and (3) criteria reflecting the 5
professional judgment of the practitioner. The 6
criteria selected would serve as an appropriate 7
basis for measuring progress toward the organi- 8
zation's objectives. A report which identifies 9
opportunities for improvement may, by its tone 10
or content, reflect indirectly on current 11
performance though it was not directly intended 12
to provide an assessment of performance. In 13
other cases, current operations may be compared 14
against measurement criteria and the comparison 15
will be made specifically to assess performance. 16

- Identifying Opportunities for Improvement. 17
Increased economy, efficiency, or effectiveness 18
of operations are the broad categories under 19
which most improvements may be classified. 20
Identification of specific opportunities for 21

improvement may result from activities such as 1
analysis of interviews with individuals both 2
within and outside the organization, observation 3
of operations, reviews of past and current 4
reports, reviews of transactions, comparison with 5
industry standards, and the exercise of profes- 6
sional judgment based on experience. 7

- Developing Recommendations for Improvement or 8
Further Action. The nature and extent of 9
recommendations developed in the course of 10
operational audits will vary considerably. In 11
many cases, the operational auditor may be able 12
to make specific recommendations for improvement 13
based on engagement findings. In other cases, 14
however, extensive, detailed analysis or further 15
study not within the scope of the engagement may 16
be required, and the "recommendation" may simply 17
state a need for further study of the area in 18
question. 19

Benefits Provided

Operational auditing by the independent CPA firm is 20
intended to provide an objective review of the organization's 21

performance in planning, executing, and controlling operations. 1
Depending on its scope, an operational audit engagement may 2
provide some or all of the following benefits which may or may 3
not be stated as specific engagement objectives: 4

- Identification of previously undefined organi- 5
zation objectives, policies, and procedures. 6
- Identification of criteria for measuring the 7
achievement of organization objectives. 8
- An independent, objective evaluation of speci- 9
fied operations. 10
- Determination of compliance with organization 11
objectives, policies, and procedures. 12
- Determination of the effectiveness of management 13
control systems. 14
- Determination of the reliability and usefulness 15
of management reports. 16
- Identification of problem areas and underlying 17
causes. 18
- Identification of potential profit improvement, 19

revenue enhancement, and cost reduction or 1
containment areas. 2

- Identification of alternative courses of action. 3

Characteristics of Operational Audit Engagements 4

It is logical that independent CPA firms should be asked 5
to conduct or participate in operational audit engagements 6
because they possess certain applicable skills, an insight into 7
business operations, and an appreciation for the relationship 8
between financial and operating controls. Operational and 9
financial audits share many common activities including: 10

- Planning, control, and supervision. 11
- Fact-finding, analysis, and documentation. 12
- Recommending. 13
- Reporting. 14

Each of these activities is familiar to the CPA who, by 15
virtue of education, experience, and independence, can bring 16
professional competence to the performance of operational 17
audits. However, depending upon the specific engagement, 18
additional special technical or functional expertise may be 19

required to supplement the CPA's basic skills. Management 1
Advisory Services (MAS) practitioners on the staffs of many 2
CPA firms frequently possess many of these needed skills. In 3
the conduct of an operational audit, it is important that 4
competence to perform the in-depth fact-finding and analysis 5
of the operations to be reviewed is considered. An effective 6
operational audit team would consist of a staff with the 7
needed skills. 8

Although the approaches may be similar, there is a 9
significant difference in purpose between an audit of financial 10
statements and an operational audit. The purpose of the finan- 11
cial audit is to express an opinion on the fairness with which 12
an entity's historical financial statements present financial 13
position, results of operations, and changes in financial 14
position in conformity with generally accepted accounting 15
principles or other comprehensive bases of accounting. The 16
purposes of an operational audit are to assess performance, 17
to identify opportunities for improvement, and to develop 18
recommendations. 19

Activities performed by CPA firms which are described 20
as management advisory service engagements for clients have 21
much in common with operational audit engagements. Management 22
advisory services are described in the AICPA's Statements on 23

<u>Management Advisory Services</u> as follows:	1
The function of providing professional advisory	2
(consulting) services, the primary purpose of	3
which is to improve the client's use of its	4
capabilities and resources to achieve the	5
objectives of the organization....In providing	6
this advisory service, the independent account-	7
ing firm applies an analytical approach and	8
and process which typically involve--	9
● Ascertaining the pertinent facts and	10
circumstances,	11
● Seeking and identifying objectives,	12
● Defining the problem or opportunity for	13
improvement.	14
● Evaluating and determining possible	15
solutions, and	16
● Presenting findings and recommendations,	17
and, following the client's decision to	18
proceed...	

- Planning and scheduling actions to achieve the desired results, and 1 2
- Advising and providing technical assistance in implementing...to produce solutions.... 3 4

This description of activities performed during an MAS engagement generally applies to an operational audit engagement. Implementation assistance would usually not be included in an engagement to perform an operational audit. Frequently, however, assistance in the implementation of recommendations may be obtained by the report recipients subsequent to the operational audit engagement. The report on the engagement findings should seek to stimulate further action where necessary. 5 6 7 8 9 10 11 12 13

Whether a firm classifies an operational audit engagement as an MAS engagement or something else has no bearing on the conduct of the engagement. More important is the understanding of the clear difference in purpose of a separate, in-depth engagement that is conducted as an operational audit. It should not be confused with the level of work performed as part of a financial audit engagement for the purpose of developing a management letter, though the techniques used may indeed be similar. The difference in magnitude should be 14 15 16 17 18 19 20 21 22

significant when a CPA firm specifically undertakes an engagement to perform an operational audit.

Since the purposes of an operational audit engagement are to assess performance, to identify opportunities for improvement, and to develop recommendations, there can be considerable differences, also, in the engagement understandings for different operational audit engagements. At one extreme would be, for example, an engagement for a regulatory body, resulting in a report concerned solely with assessing the performance of an organization because that is the purpose of the engagement. The other extreme would be an engagement where a client has severe operations problems and the purpose of the engagement is to develop in-depth recommendations documenting one or more ways in which those problems might be corrected. The middle-of-the-spectrum engagement may be one in which the CPA firm is asked to review the operations and to report weaknesses, but to spend little time developing recommendations. Most engagements will reflect a combination of purposes.

Because of this latitude in specifying the purpose(s) of an operational audit engagement, care should be exercised in preparing the engagement letter to prevent a misunderstanding by either party as to the purpose and objective of the specific engagement. It should be noted that the purpose

of the engagement may make a difference in the CPA firm's decisions as to the skills required to undertake the engagement. 1
2

While the purpose of financial audit engagements differ 3
from operational audit engagements as indicated above, it is 4
also clear that the activities performed and the skills 5
required overlap. Operational audit engagements, therefore, 6
allow the independent CPA firm to further use its capabilities 7
and experience to benefit clients as well as third parties 8
interested in an independent review of the economy, efficiency, 9
and effectiveness of an entity's operations or a segment 10
thereof. 11

2. ARRANGEMENTS FOR OPERATIONAL AUDIT ENGAGEMENTS

To establish a mutual understanding of the purposes, objectives, and scope of an operational audit, the practitioner would usually:

1. Establish the primary and other purposes of the engagement.
2. Identify the objectives of the engagement and consider their achievability.
3. Consider whether the scope of the engagement is sufficient to permit a substantive review of the function or activity being examined.
4. Establish that the individual or entity requesting the service has the authority to do so.
5. Ascertain that individuals possessing competence in the technical subject matter under consideration will be available to perform the engagement.
6. Ascertain that the engaging party has agreed

to the nature and scope of the work to be 1
performed, the approach to be followed, and 2
the end products to be expected. 3

This understanding is usually confirmed in writing in the form 4
of a proposal, contract, or a letter confirming arrangements 5
for the engagement. 6

Objectives of the Engagement 7

It is important that a mutual understanding be reached 8
as to the objectives of the engagement. (See Page 8 for 9
some possible objectives.) Further, a practitioner should not 10
accept an operational audit engagement unless he is free to 11
exercise his independent judgment within the scope of the 12
engagement. This does not mean that the practitioner cannot 13
perform an engagement when the engaging party has anticipated 14
certain findings; only that that party should understand and 15
agree that it will not influence the practitioner's evalua- 16
tion and presentation of the findings. 17

Sufficient Scope

Many operational audits will be directed to specific 18

segments or functions of an organization rather than the 1
entire organization. The scope of an operational audit 2
should be sufficient to achieve a substantive evaluation of 3
the organization or segments thereof being examined. If the 4
engaging party wishes certain areas to be excluded from the 5
review, the practitioner should consider the potential impact 6
of the exclusions on the final results. The practitioner may 7
conclude that the exclusions prohibit a review of essential 8
areas which, if omitted, would limit the likelihood of achiev- 9
ing the engagement's objectives. If so, discussion of this 10
with the engaging party would be appropriate. 11

Authority for Requesting Operational Audit 12

A practitioner may, on occasion, be requested to perform 13
an operational audit of an organization or a segment of an 14
organization by a third party. In such cases, the practitioner 15
needs to determine that the engaging party has the proper 16
authority, and that the organization to be reviewed is expected 17
to cooperate to the extent necessary for successful completion 18
of the operational audit. 19

Knowledge and Experience 20

An effective operational auditor need not be expert in 21

all the areas to be reviewed, though the capability to recognize when special knowledge or experience is required to analyze a given area is important. Operational audits may require the application of diverse kinds of technical, functional, and industrial or governmental program knowledge and experience, and it is incumbent upon the practitioner to determine that needed expertise for the operational audit will be available. Accounting and financial knowledge and experience are available to a CPA firm through its auditing staff, and other needed expertise may be available in the firm's management advisory services and tax staff.

Cooperative Engagements

In certain circumstances it might be appropriate to use other professionals who might not be on the CPA firm staff (e.g., engineers, actuaries, or physicians) to perform certain aspects of an operational audit. SAS 11, Using the Work of Specialists, applies to financial audit engagements. In operational audits, however, the considerations identified in MAS Guideline Series No. 5, Guidelines for Cooperative Management Advisory Services Engagements, appear more appropriate:

Proposals and reports (for cooperative engagements) will typically be issued in one of the following manners:	1 2 3
1. <u>The practitioner issues the proposal or report, assuming full responsibility for the work of other participants. This is appropriate when the CPA is the prime contractor and is competent to evaluate other participants' work.</u>	4 5 6 7 8
2. <u>The practitioner issues the proposal or report specifically identifying those aspects of the engagement for which he is relying on other participants as experts. This is appropriate when the CPA is the prime contractor.</u>	9 10 11 12 13
3. <u>Another participant issues the proposal or report, either assuming full responsibility for the practitioner's work or identifying those aspects of the engagement for which he is relying on the practitioner. This is appropriate when the practitioner is a subcontractor.</u>	14 15 16 17 18 19 20
4. <u>A joint proposal or report is issued by participants, with each participant's scope of work clearly defined. This could be appropriate where the involvement of each participant is significant.</u>	21 22 23 24 25
5. <u>Separate proposals or reports are issued. This is appropriate (a) for proposals or reports involving cooperative participation without a contractual relationship among participants, (b) when separate reports appear desirable and are acceptable to the client, or (c) when separate reports are requested by the client.</u>	26 27 28 29 30 31 32
For all engagements in which the client is aware of a practitioner's participation, the practitioner should retain and exercise his right to review the proposal and any subsequent presentation of his findings and conclusions.	33 34 35 36 37

If a cooperative engagement is undertaken, the role and responsibilities of any substantive subcontractors to the CPA firm needs to be defined and agreed to in advance by both parties, as well as the engaging party.

Engagement Document

The engagement agreement for an operational audit may take the form of a proposal letter, contract, or confirmation letter. It serves to establish an understanding of the engagement between the practitioner and the engaging party.

Subjects to be considered include:

- Purposes and objectives of the operational audit.
- Background of the engagement.
- Scope of the review.
 - Areas or activities included or excluded.
 - Sources and possible limitations of relevant data.
 - Other limitations anticipated.
- Approach or work plan to be followed.
- Evaluative criteria to be used.

● Course of action to be followed in the absence of criteria.	1 2
● Nature of end products to be expected from the operational audit, particularly with respect to whether, and to what extent, recommendations for corrective actions are to be included.	3 4 5 6 7
● Special understandings, if any (e.g., that the CPA firm will not express opinion on the overall level of efficiency and economy that the organization achieves in using its resources to carry out operations, or any other special understanding agreed to or specified by the firm).	8 9 10 11 12 13 14
● Staffing. --Subcontractor(s) or other professionals and the scope of their work.	15 16 17
● Extent of client involvement.	18
● Estimated time and fee.	19
● Billing arrangements.	20

- Progress reports. 1
- Report distribution. 2
- Follow-up arrangements. 3

3. OPERATIONAL AUDIT ENGAGEMENT ACTIVITIES

Once the scope of the engagement has been agreed upon, 1
the practitioner can develop a preliminary outline summarizing 2
the general approach. While each engagement will differ in 3
its detail, the following activities are of particular 4
importance: 5

- Planning, control, and supervision. 6
- Fact-finding, analysis, and documentation. 7
- Recommending. 8
- Reporting. 9

Planning, Control, and Supervision 10

These activities include the development of a work 11
program, the scheduling of the work to be done, the selection 12
of the appropriate staff, the involvement of the organization's 13
personnel, performance of work, and provision for final review 14
of work papers and reports. 15

A work program is developed in accordance with the 16
circumstances and objectives of each engagement and is 17
tailored to the organization to be reviewed. In developing 18
the work program, consideration is given to the appropriate 19

sequence of specific tasks, research required (both internal 1
and external), and the people to be interviewed. 2

Fact-Finding, Analysis, and Documentation 3

An operational audit involves the practitioner becoming 4
familiar with the organization being reviewed. This would 5
usually include, among other things, becoming knowledgeable 6
about the nature of the organization and its products or 7
services, and the objectives, policies, systems, procedures, 8
methods, and results relating to the operations under study. 9
If only a segment of an organization is being studied, it 10
would be appropriate to understand its relationship to other 11
segments of the organization. The methods selected would 12
depend on the circumstances, but may generally include 13
interview, observation, substantiation, documentation, and 14
analysis. 15

Effective interviewing is often essential to the success- 16
ful conduct of an operational audit engagement. It is a direct 17
way of gathering information. Manuals, reports, and similar 18
materials may not reflect organization, activities, policies, 19
and procedures as they actually are at the time of the study. 20
Moreover, interviewing will provide insight into problems as 21
seen by those who must live with them on a day-to-day basis. 22

An operational auditor will often find the comments, impressions, and suggestions of the organization's personnel--management and staff--to be invaluable in providing clues to tracking down weaknesses and opportunities for improvement.

Observation of operations provides an effective means of seeing what is actually being done in relation to what is supposed to be done. Observing policies and procedures in action would facilitate commenting on their appropriateness and effectiveness.

The process of substantiation entails review of evidential matter to determine that information obtained during the interview and observation process is appropriately supported.

Analysis involves studying the facts and measuring them against various performance criteria to determine whether specified organization objectives are achieved. Where the objectives are not fully achieved, the degree of risk to the organization, or inefficiency, may also be determined. If appropriate to the nature of the findings and scope of the operational audit, analysis would include the development and documentation of alternative recommendations.

Documentation consists of compiling and recording sufficient relevant data to support conclusions and recommendations. The form of documentation will vary from engagement

to engagement, and may consist of items such as charts, 1
schedules, interview notes, forms, manuals, analyses, reports, 2
and memoranda. (Documentation would include materials 3
concerning the fact-finding activities, the analytical process 4
applied by the practitioner, and the recommendations made, 5
as appropriate.) 6

Recommending 7

When operational audits are not directed primarily 8
toward assessing performance, clients often look upon recommen- 9
dations as that portion of the report of greatest value to 10
them. Findings often confirm problems management already 11
knew or believed existed; recommended solutions provide new 12
input. 13

Recommendations may range from a complete plan of 14
action to a suggestion for further study. The appropriate 15
development of alternative solutions and recommendation of 16
specific courses of action can require considerably more time 17
and effort from the operational auditor than does pinpointing 18
the problems. Therefore, when operational audits are under- 19
taken, the degree of effort to be placed on developing recom- 20
mendations should be established at the outset, lest the 21
engaging party expect more than the practitioner plans to 22
provide. Implementation assistance would not usually be a 23
part of an operational audit engagement. A follow-up 24

engagement to further develop specific recommendations, or 1
develop an action plan or assist in implementation, might 2
be appropriate. 3

Reporting 4

The operational audit report is discussed more fully 5
in Chapter 5. It will vary depending on circumstances and 6
on the needs of the engaging party, as agreed to before the 7
engagement. Typically, the report would include a descrip- 8
tion of the work done, an identification of the areas with 9
potential for improvement, and the specific recommendations. 10
The recommendations may be separated into short term and 11
long range categories. 12

4. CONDUCT OF AN OPERATIONAL AUDIT ENGAGEMENT

The level of fact-finding and analysis generally done 1
in the preparation of a management letter associated with a 2
financial audit does not entail the degree of depth and 3
comprehensiveness that typify a separate operational audit 4
engagement. Among the factors that may (or may not) receive 5
increased attention, depending upon the purposes, objectives, 6
and scope of a particular operational audit engagement, are: 7

- The organization's goals, objectives, and 8
policies. 9
- Organizational structure. 10
- Management and operations personnel. 11
- Purposes served by functional activities. 12
- Products or services. 13
- Locations, facilities, and equipment. 14
- Relationships with other organizations, units, 15
governmental entities, customers, suppliers, 16
unions, and so forth. 17

- External factors such as markets, competition, state of the economy, and availability of raw materials. 1
2
3
- Operating and administrative control systems. 4
- Management information systems. 5
- Administrative and production systems and procedures. 6
7
- Internal and external communications. 8
- Use and safeguarding of resources. 9
- Productivity of equipment and personnel. 10
- Cost of services or products provided. 11
- Results (profits or services rendered). 12

The factors to be reviewed and the extent of the review are predicated upon the agreement between the practitioner and engaging party as to the scope of the engagement. If an organization's operations, as a whole, are to be reviewed, all of these factors may be included. If a specific function (e.g., purchasing, EDP, marketing) or a segment

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(e.g., location, division) of the entity is to be reviewed, 1
some of the listed items may not apply. 2

Criteria for Identifying 3
Improvement Opportunities 4

When possible, activities under study should be 5
measured against relevant, accepted criteria (yardsticks of 6
efficiency, effectiveness, or results) to support judgmental 7
conclusions and recommendations. However, even in the absence 8
of any industry or activity standard other than current 9
performance, recommendations leading to more effective, 10
efficient, and economical operations can still be supported. 11

Relevant standards of performance can be derived by 12
the practitioner from both internal and external sources: 13
(1) internally generated measurement yardsticks such as 14
stated goals, objectives, historical results, policies, 15
procedures, pronouncements, commitments, budgets, corporate 16
plans and capacities, and (2) externally generated measure- 17
ment yardsticks such as legislative language, contractual 18
terms, industry standards, productivity studies, trends and 19
comparative performance, authoritative publications, and 20
previous experience of the practitioner or firm with similar 21
activities. 22

Depending on the circumstances, agreement might be 1
reached with the engaging party to rely on either internal 2
or external criteria alone. When practical, it is preferable 3
to use objective, documentable standards, since these give 4
the findings a more authoritative foundation and enhance 5
credibility and acceptance. 6

Measurement criteria may be supplied by the engaging 7
party or, in the absence of such criteria, developed by the 8
operational auditor, subject to acceptance by that party. 9
Such development work would generally entail an expansion of 10
the engagement's scope or a separate engagement. 11

Selection of the criteria to be used is important, 12
particularly when an assessment of current performance is to 13
be reported. Appropriate criteria would be unbiased, rele- 14
vant, and sufficient to support the conclusions and recommen- 15
dations. A discussion with the engaging party of the 16
measurement criteria to be used, prior to applying them as a 17
basis for evaluating a specific activity, would be 18
appropriate. 19

Work Program 20

While the scope and extent of an operational audit will 21
differ in each case, the general sequence of activities 22

outlined below provides information useful in developing an 1
engagement work program. As with many other types of engage- 2
ments, a preliminary survey may be desirable prior to develop- 3
ing a detailed work program so that subsequent phases of the 4
operational audit can be more specifically defined and 5
planned. 6

The following listing of the more frequently encountered 7
activities in an operational audit engagement is divided into 8
five phases. The decisions as to which activities would apply 9
to a specific engagement, and to what extent, would be based 10
on the terms of the engagement and the practitioner's on-site 11
judgment. 12

Phase I - Orientation 13

- Determine organization history, objectives, 14
structure, functions, products/services, and 15
programs. 16
- Review available data on industry, functions, 17
products/services, and programs. 18
- Review organization charts, policy statements. 19
procedure manuals, performance standards, past 20
performance data, applicable laws, and other 21
pertinent data. 22

● Review the business plan, financial statements, and forecasts.	1 2
● Review internal management reports, internal and independent audits, consultants' reports, management letters, and so forth.	3 4 5
<u>Phase II - Field Study</u>	6
● Interview key personnel at all organizational levels. Identify and interview external sources of pertinent information if this can be done without violating the confidentiality of the engagement.	7 8 9 10 11
● Observe and document or chart operational activities.	12 13
● Review internal control systems and reports (financial and administrative, including productivity).	14 15 16
● Review transaction flow.	17
● Review and document staffing, equipment, forms, and reports.	18 19

● Review key aspects of such functional	1
activities as purchasing, personnel, EDP,	2
production, accounting, marketing, or industry	3
and government program areas, using specially	4
prepared questionnaires when appropriate.	5
● Discuss proposed use of measurement criteria	6
with appropriate personnel.	7
<u>Phase III - Analysis</u>	8
● Relate collected data to performance measure-	9
ment criteria, when appropriate.	10
● Assess business risks and inefficiencies to	11
determine areas and activities where performance	12
may be improved; document findings and potential	13
benefits.	14
● Reconfirm measurement criteria with appropriate	15
personnel.	16
● Discuss findings and improvement opportunities	17
with appropriate personnel.	18
● Document alternatives, recommendations, and	19

need for further study as related to key	1
improvement opportunities.	2
<u>Phase IV - Final Report Preparation and Presentation</u>	3
● Organize and draft report of findings, recommen-	4
dations, and benefits.	5
● Develop implementation plan and timetable for	6
recommendations, if appropriate.	7
● Discuss report with appropriate executives and	8
managers of the organization reviewed and the	9
engaging party, if different.	10
● Present report.	11
<u>Phase V - Follow-Up (if requested)</u>	12
● Revisit the organization to discuss corrective	13
action taken or proposed.	14

5. REPORTING OPERATIONAL AUDIT FINDINGS AND RECOMMENDATIONS

A report resulting from an operational audit engagement 1
is intended to provide an understanding of the facts and the 2
rationale for the conclusions and recommendations. The report 3
will usually be addressed to the person(s) with whom the 4
arrangements were made for the engagement, which could be a 5
board of directors, a senior executive, or a third party(s). 6

Distribution of the report would generally be limited 7
to the addressee. Any further distribution would be at the 8
engaging party's direction. Usually, the practitioner would 9
not place a restriction on the distribution of the report. 10
The fact that it may be circulated to others should be kept 11
in mind when it is being prepared. 12

Prior to distributing an operational audit report, a 13
discussion of pertinent sections with appropriate officials 14
or executives would help to assure the accuracy of facts and 15
to facilitate understanding and acceptance of the report by 16
those to whom it is directed. Management's response to the 17
report or management's comments may be included with the 18
report or presented in a separate letter or report. 19

Content of the Report

While operational audit reports will vary in format, a report generally contains the following elements:

- Objectives and Scope of the Engagement.
- General Procedures or Approach.
- Specific Findings and Recommendations.

It may also be appropriate to include an executive summary of the report contents and conclusions. If a report is short, there may be no need for a summary; the report itself will be sufficient. On the other hand, if a report is lengthy and detailed, a summary may be useful.

Objectives and Scope of the Engagement. It is unlikely that all the activities in an enterprise would be covered in a single engagement, or that every review procedure identified earlier will be performed. A summary of the objectives and scope agreed upon is usually useful.

General Procedures or Approach. Since the extent of operational audits varies depending on the engagement, a general description of the procedures employed is often useful. A description of limitations on the engagement imposed by

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the engaging party would also be pertinent in many cases. 1

Additionally, this section might include a discussion of: 2

- Rationale. The reasons for selecting the procedures used in fact-gathering--e.g., discussion, observation, or work sampling. 3
4
5
- Measurement Criteria. A description of their origin and application. 6
7

A reminder that an operational audit report generally focuses 8
on weaknesses and areas for improvement, rather than on 9
enumerating the many strengths of the organization, may be 10
appropriate. It may also be appropriate to state that the 11
report's findings and conclusions are based upon the organi- 12
zation's operations during a specified period. 13

Specific Findings and Recommendations. The structure 14
of the report is not as important as the content. It may, 15
for example, be organized by operation or by subject, e.g., 16
organization, data processing controls, productivity, and so 17
forth. Under each section, the related findings and recommen- 18
dations would be presented. 19

It should be remembered that some operational audit 20
engagements, particularly those sponsored by third parties, 21

may not involve recommendations. In such cases, the specific findings might consist of an assessment of performance, with no recommendations for improving performance.

More frequently, there are definite recommendations included in the report. The nature, number, and detail of recommendations included in the report involve the exercise of professional judgment based on the purpose and scope of the engagement and the information gathered and conclusions reached during the course of the review. Recommendations presented are not always limited to matters which can be objectively determined.

In any case, the practitioner may, when appropriate, include recommendations for further study of areas that were not subjected to a sufficiently detailed review, or where appropriate recommendations were not developed due to the constraints of the engagement. Generally, a recommendation for further study would be supported by an explanation of why it might be desirable or beneficial.

Exhibit 1 illustrates the kind of introductory language that might appear in an operational audit report. Appendix A consists of summaries intended to illustrate a variety of operational audit engagements, and the variety of data that might be included in an operational audit engagement report. The material in Appendix A is not intended as a guide for the format of an operational audit report.

Illustration of Introductory Language for an Operational Audit Report

To the Report Recipient 1
The Engaging Party 2
New York, New York 12345 3

In December 19__ we concluded an operational audit of 4
XYZ (company, department, and so forth). 5

Objectives and Scope 6

The general objectives of this engagement, which were 7
more specifically outlined in our letter dated September __, 8
19__, were as follows: 9

- To document, analyze, and report on the 10
status of current operations. 11
- To identify areas which require attention. 12
- To make recommendations for corrective 13
action or improvements. 14

Our operational audit encompassed the following units: 15
Branch A, Branch B, and Branch C, plus the entire home office 16
operation. Our evaluations included both the financial and 17
operational conditions of the units. Financial data 18

consulted in the course of our analyses were not audited by 1
us and, accordingly, we do not express an opinion on them. 2

Approach 3

The operational audit involved interviews with manage- 4
ment personnel and selected operations personnel in each of 5
the units studied. We also reviewed and evaluated appropriate 6
documents, files, reports, systems, procedures, and policies. 7
After analyzing the data obtained, we developed recommenda- 8
tions with appropriate unit management personnel, and with you, 9
prior to submitting this written report. 10

Findings and Recommendations 11

The recommendations in this report represent, in our 12
judgment, those most likely to bring about beneficial improve- 13
ments to the operations of the organization. However, all 14
significant findings are included in the balance of this 15
report for your consideration. It should be noted, in making 16
your decisions, that the recommendations differ in such consi- 17
derations as difficulty of implementation, urgency, visibili- 18
ty of benefits, required investment in facilities, equipment 19

EXHIBIT 1.3

or additional personnel, and other factors. The varying 1
nature of the recommendations, their implementation costs, 2
and their potential impact on operations should be considered 3
in reaching your decisions on courses of action. 4

* * * * *

6. CPA PROFESSIONAL STANDARDS AND OPERATIONAL AUDIT ENGAGEMENTS

The purpose of this chapter is to identify certain standards adopted by the accounting profession which would apply to operational audits performed by CPA firms. The accounting profession, through the AICPA, has issued practice standards that fall into two major categories:

1. Rules of Conduct that apply generally to all activities of a CPA in public practice.
2. Practice and technical standards that relate to specific services offered by CPAs in public practice.

Rules of Conduct

In the conduct of an operational audit engagement by a CPA firm, the Rules of Conduct and, in particular, the general standards under Rule 201 apply. The rules having greatest applicability to an operational audit engagement are as follows:

Rule 102 - Integrity and Objectivity. A member shall not knowingly misrepresent facts, and when engaged in the practice of public accounting...shall not subordinate his judgment to others.

<u>Rule 201 - General Standards.</u>	1
comply with the following general standards as	2
interpreted by bodies designated by Council, and	3
must justify any departures therefrom.	4
a. <u>Professional Competence.</u>	5
A member shall	6
undertake only those engagements which he or	7
his firm can reasonably expect to complete	8
with professional competence.	
b. <u>Due Professional Care.</u>	9
A member shall exercise due professional care in the performance	10
of an engagement.	11
c. <u>Planning and Supervision.</u>	12
A member shall	13
adequately plan and supervise an engagement.	
d. <u>Sufficient Relevant Data.</u>	14
A member shall	15
obtain sufficient relevant data to afford a	16
reasonable basis for conclusions or recommendations	17
in relation to an engagement.	
e. <u>Forecasts.</u>	18
A member shall not permit his	19
name to be used in conjunction with any forecast	20
of future transactions in a manner which	21
may lead to the belief that the member vouches	22
for the achievability of the forecast.	
<u>Rule 301 - Confidential Client Information.</u>	23
A member shall not disclose any confidential information	24
obtained in the course of a professional engagement	25
except with consent of the client.	26
<u>Rule 302 - Contingent Fees.</u>	27
Professional services	28
shall not be offered or rendered under an arrangement	29
whereby no fee will be charged unless a specified	30
finding or result is attained, or where the	31
fee is otherwise contingent upon the findings or	32
results of such services. However, a member's fee	33
may vary depending, for example, upon the complexity	34
of the service rendered.	
<u>Rule 503 - Commissions.</u>	35
A member shall not pay a	36
commission to obtain a client, nor shall he accept	37
a commission for a referral to a client of products	38
or services of others.	

Practice and Technical Standards

The specific standards which apply to financial audit engagements do not apply to operational audits. However, some Statements on Auditing Standards may provide useful information for the operational auditor. Pronouncements concerning areas, such as the following, may be particularly informative.

Reviews of and reports on internal control. 7

Relationships with internal auditors. 8

Using the work of a specialist. 9

The practice standards which apply to management advisory services engagements were not promulgated with operational auditing engagements specifically in mind, though some CPA firms may classify such engagements as MAS engagements. Several AICPA Management Advisory Services publications may also provide useful information for the operational auditor, particularly the following:

Operational Reviews of the Electronic Data Processing Function 17
18

CPA Participation in Government Audit Engagements to Evaluate Economy, Efficiency, and Program Results 19
20
21

Cooperative Management Advisory Services	1
Engagements	2
Statements on Management Advisory Services	3
Documentation Guides for Administration of	4
MAS Engagements	5

APPENDICES

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 1

ORGANIZATION AUDITED: Mass transit company.

TYPE OF ORGANIZATION: Corporation owned by the city with a board of directors.

PURPOSE OF OPERATIONAL AUDIT: The transit company receives substantial amounts of operational funding from the state and federal governments. Under state law, each region's transportation planning agency is responsible for insuring that operational audits are conducted of transit operators in the area receiving state funding.

PRINCIPAL RECIPIENTS OF OPERATIONAL AUDIT REPORT:

1. Board of directors of organization audited.
2. Transportation planning agency requesting audit.

AUDIT OBJECTIVE: To provide an independent evaluation of the efficiency and effectiveness of the mass transit company.

SCOPE OF AUDIT:

1. The audit addressed operations for one year--1977.
2. In-depth audits of the operations of three functional areas--Maintenance, Safety Management, and Claims Management.
3. Summary audits of eight functional areas--Service Planning, Transportation Operations, Fare Structure Management, Marketing and Public Relations, Budgeting and Financial Planning, Management Reporting, Purchasing and Personnel Management.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT:

Through conducting interviews and reviewing documentation, the auditor determined the answers to questions designed to identify the key criteria/performance measures for each functional area. The key criteria/performance measures questions were derived from a transit operators' operational audit guide which had been prepared for the regional transportation agency. For those functional areas selected for detailed audit, additional interviews and tests were conducted to probe each of the criteria/performance measures in greater depth.

MEASUREMENT CRITERIA:

The state (California) had defined performance indicators intended as overall measures of transit operators' efficiency and effectiveness. The scope of audit included reviewing the operators' performance for each of the following indicators:

Efficiency:

Cost per vehicle service hour.
Cost per vehicle service mile.
Cost per passenger.
Service hour per employee.

Effectiveness:

Passengers per vehicle service mile.
Passengers per vehicle service hour.

SPECIFIC FINDINGS AND
RECOMMENDATIONS:

Findings and recommendations were presented for each functional area examined.

SPECIAL COMMENTS AND
LIMITATIONS:

1. The report does not contain an overall opinion on the efficiency or effectiveness of the transit company.
2. The section of the report presenting measurement criteria notes that the amounts are based on data provided by

APPENDIX A-1.3

the transit company and are unaudited in that they have not been subject to audit procedures performed in accordance with generally accepted auditing standards.

3. The section also notes the limitations of using measurement criteria in comparing the performance of one organization to another. The report identifies a number of factors which must be considered in the comparison-- service area population, service area miles, age of systems, number of vehicles, and types of service--and concludes that a mere numerical comparison of the performance indicators of the transit operators in the geographic region does not afford a valid comparison of their relative efficiency and effectiveness.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 2

ORGANIZATION AUDITED: Data processing department.

TYPE OF ORGANIZATION: Financial Institution.

PURPOSE OF OPERATIONAL AUDIT: Senior management of organization was concerned that data processing department was not operating effectively.

PRINCIPAL RECIPIENTS OF OPERATIONAL AUDIT REPORT: President, executive vice president, and vice president of data processing.

AUDIT OBJECTIVE: To assess the adequacy of data processing operations in meeting the needs of the organization.

SCOPE OF AUDIT:

1. Administration, Organization, and User Evaluation.
2. Planning and Operations.
3. Hardware Utilization.
4. Data Communication.
5. Information Resource Management.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT:

- . Key users in the organization were interviewed.
- . Major documents were reviewed, including plans, budgets, employee training records.
- . Actual operations were observed over a period on a random basis.
- . Hardware records were analyzed on usage.

MEASUREMENT CRITERIA:

The areas contained in the AICPA publication, Operational Reviews of the Electronic Data Processing Function.

SPECIFIC FINDINGS AND RECOMMENDATIONS:

Findings and recommendations were presented in five major categories: Administration, Organization, Planning, Hardware Utilization, and Information Resources.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 3

ORGANIZATION AUDITED: County government.

TYPE OF ORGANIZATION: Elected county board members. Elected and appointed officials for each operating department/office.

PURPOSE OF OPERATIONAL AUDIT: To help contain increasing costs of operations in relation to services provided, and to establish a structured wage and salary administration program as one control.

PRINCIPAL RECIPIENTS OF AUDIT REPORT: All members of the county board.

AUDIT OBJECTIVE: Determine effectiveness of current methods and procedures in the delivery of public services. Establish appropriate wage and salary administration practices.

SCOPE OF AUDIT: All work related activities in the elected offices of the auditor, county clerk, circuit clerk, circuit court, coroner, county board, recorder, sheriff, states attorney, and treasurer and the departments of appointed officials including animal disease control, supervisor of assessments, building and maintenance, civil defense, detention, education, health, highway, industrial development and planning, jury commission, microfilm and printing, nursing home, probation, and radio.

All non-elected personnel employed by the county in the above offices and departments.

APPENDIX A-3.2

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT:

Completion of position description questionnaires by each employee.

In-depth interviews of selected employees to verify reporting relationships, work-flow requirements, duties, and responsibilities.

Observations of methodology used in performing assigned duties and responsibilities.

Review of written policies and procedures.

Review available personnel records to identify sources and losses of employees.

Identify relevant sources of current wages/salaries applicable to selected positions within the county.

Conduct job evaluation of each position, using predetermined evaluative criteria.

Classify and rank each position.

Develop salary ranges for each classification.

MEASUREMENT CRITERIA:

Minimum requirements of applicable county, state, and federal laws, rules, and regulations.

Comparative analysis with performance standards for similar work activities performed by other governmental units and private industry.

Accuracy and timeliness of work output.

Use of management tools for planning, scheduling, and controlling work activities.

Availability of data/information for management of county functions.

SPECIFIC FINDINGS AND
RECOMMENDATIONS:

High cost of data processing operation in relation to other alternatives.

Unreliable output from data processing vendor and underutilization of data processing resources.

Duplication of clerical work activities.

Underutilization of personnel and equipment within certain departments.

Lack of coordination of available personnel within various offices.

Insufficient cost accounting system for controlling highway project costs.

Lack of planning and scheduling of work activities.

Absence of any formal training program.

SPECIAL COMMENTS AND
LIMITATIONS:

Final report included position descriptions for all (non-elected) positions; wage/salary ranges for twenty classification levels; a compliance review of personnel related policies, procedures, and practices; an employees' manual of personnel benefits, policies, and procedures.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 4

ORGANIZATION AUDITED:	Manufacturer of pre-insulated pipe.
TYPE OF ORGANIZATION:	Private closely held corporation.
PURPOSE OF OPERATIONAL AUDIT:	To provide recommendations for improving efficiency and effectiveness of office operations.
PRINCIPAL RECIPIENTS OF AUDIT REPORT:	President and office manager.
AUDIT OBJECTIVE:	Determine ways in which office procedures may be streamlined to improve efficiency and effectiveness.
SCOPE OF AUDIT:	All activities performed by the seven people in the office, excluding the marketing related functions.
GENERAL PROCEDURES/ APPROACH TO CONDUCTING AUDIT:	Interview office personnel to determine their duties. Flowcharting of paper flow. Review reports resulting from the office procedures in use. Analyze interview notes, flowcharts, and reports to develop findings.
MEASUREMENT CRITERIA:	Are the same data being recorded more often than necessary? Are unused copies being created? Are unnecessary multiple files being maintained? Is paperwork being handled by too many people?

APPENDIX A-4.2

SPECIFIC FINDINGS AND
RECOMMENDATIONS:

Report provided a series of specific procedural recommendations in response to findings.

SPECIAL COMMENTS AND
LIMITATIONS:

Study was limited to office procedures only. Although implementation of recommendations could have resulted in reduced office staff, the owners choose to retain their personnel.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 5

ORGANIZATION AUDITED: Public utility.

TYPE OF ORGANIZATION: Investor owned utility.

PURPOSE OF OPERATIONAL AUDIT: To evaluate the efficiency and effectiveness with which company was being managed.

PRINCIPAL RECIPIENTS OF OPERATIONAL AUDIT REPORT: Public service commission members.

AUDIT OBJECTIVE: Evaluate management and operation efficiency, identify opportunities for improvement, and recommend actions for implementation.

SCOPE OF AUDIT: All organizational and functional areas.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT:

Evaluate how management strives to minimize revenue requirement.

Disaggregation of revenue requirement into a resource/function matrix with type of resource cost as one dimension and operating function as the other.

Develop financial and statistical profile (seven-year period).

Document current practices, procedures, and results (interviews and analysis).

Document areas of good practice and identify candidate areas for improvement.

Conduct in-depth study of candidate areas for improvement.

MEASUREMENT CRITERIA:

Internal comparisons--unit price levels and resource units per workload unit experienced by the utility for each year of the review period by cell matrix (function/resource matrix), and among like organizational units of the utility.

External comparisons--comparison of price levels with market indices and similar utilities: comparison of resource units per workload unit with similar utilities.

Source of change comparisons--expected values for the most recent year of the historical period (factoring up costs of the first year by identified changes in workload and price levels).

SPECIFIC FINDINGS AND RECOMMENDATIONS:

Report provided summary of overall impression, significant conclusions for each functional area, recommendations and possible plan for implementation.

SPECIAL COMMENTS AND LIMITATIONS:

Report addressed our rationale for approach and conclusions.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 6

ORGANIZATION AUDITED: Federal agency.

TYPE OF ORGANIZATION: Provides loans to individuals and organizations meeting specific qualifications.

PURPOSE OF OPERATIONAL AUDIT: To determine whether loan servicing functions and activities were efficient and effective. Agency was requesting additional personnel to perform activities.

PRINCIPAL RECIPIENTS OF OPERATIONAL AUDIT REPORT: Agency management and office of management and budget.

AUDIT OBJECTIVE: Determine if existing loan servicing procedures are appropriate in light of private industry practices and standards.

SCOPE OF AUDIT: Review of significant sample of agency regional office activities. Review of activities of a sample group of private industry lenders.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT:

- . Review of agency loan files, discussion of practices with loan officers, completion of questionnaire on servicing activities, observation of activities.
- . Interview private industry lenders and completion of questionnaire on servicing activities.

MEASUREMENT CRITERIA:

- . Comparison of activities performed by government agency to those performed by sample of private industry.
- . Subjective evaluation of review team, based upon their background and experience.

SPECIFIC FINDINGS AND
RECOMMENDATIONS:

Study with few exceptions confirmed the high quality of agency procedures and their implications for additional staff. Questioned appropriateness of agency maintaining certain loan programs.

SPECIAL COMMENTS AND
LIMITATIONS:

None.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 7

ORGANIZATION AUDITED: City government.

TYPE OF ORGANIZATION: Commission (mayor plus four commissioners) form of government.

PURPOSE OF OPERATIONAL AUDIT: Finance commissioner wanted recommendations for reducing operating costs.

PRINCIPAL RECIPIENTS OF AUDIT REPORT: City council.

AUDIT OBJECTIVE: Determine efficiency and effectiveness of current work related activities in the delivery of city services.

SCOPE OF AUDIT: All operating departments including police, fire, health, finance, streets, sewers, garbage, planning, motor vehicle, and human resources.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT: Review of recently completed job descriptions to identify duties and responsibilities of employees/departments.

Interview selected employees to determine work methods used and workload requirements.

Observe work activities.

Develop work standards for evaluation of work activities.

MEASUREMENT CRITERIA: Performance standards were developed, based on the overall output desired and the resources available as well as comparative analysis with similar work activities of other organizations.

SPECIFIC FINDINGS AND
RECOMMENDATIONS:

Inconsistent administration of personnel policies, procedures, and benefits.

Inadequate supervision of employees (i.e., lack of planning, scheduling, and monitoring of work activities).

Underutilization of available resources.

Insufficient understanding of capabilities and resources of one department by another department.

SPECIAL COMMENTS AND
LIMITATIONS:

None.

ILLUSTRATIVE OPERATIONAL AUDIT REPORT SUMMARY NO. 8

ORGANIZATION AUDITED: A manufacturing company engaged in the production and distribution of food products to both fresh and frozen markets.

TYPE OF ORGANIZATION: A public corporation.

PURPOSE OF OPERATIONAL AUDIT: Corporate management was concerned that their organization structure, job definitions, and operating procedures for the frozen market segment of this business were not providing maximum effectiveness to meet marketing and distribution requirements.

PRINCIPAL RECIPIENTS OF AUDIT REPORT: President, comptroller, and vice president of frozen foods operations.

AUDIT OBJECTIVES: To determine if the organization structure and operating processes of the frozen food operation could be improved.

To determine if job definitions and responsibilities were suitable to the needs of the operation.

SCOPE OF AUDIT: The survey covered sales management, marketing services, customer service, physical distribution, transportation, warehousing, inventory management and control, order processing, invoicing and accounts receivable, and electronic data processing of operating and performance information.

GENERAL PROCEDURES/
APPROACH TO CONDUCTING
AUDIT: On-site review of multi-plant operating and administrative processes and management controls in the departments and

functions covered.

Analysis of organization structures, job definitions, and responsibilities and authorities based on interviews and observations.

Flowcharting and documentation of work activities and interface between functions.

MEASUREMENT CRITERIA:

Organization structure and function alternatives were developed based on the requirements that would most effectively meet the production, distribution, marketing and financial capacities, and needs of the operation and corporate objectives.

SPECIFIC FINDINGS AND RECOMMENDATIONS:

Need to develop a stand-alone division organization structure with specific job roles and responsibilities rather than present structure in which key persons also have roles and responsibilities in other operating divisions of the company.

Need to assign specific leadership role to an individual who would devote full time solely to the management of a frozen products division.

Need to change order entry and processing and inventory control operations to tie in more effectively to the physical distribution, customer service, and management information activities.

SPECIAL COMMENTS AND LIMITATIONS:

None.

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* Hundreds of articles on various aspects of operational auditing have been published over the years with a large number appearing in The Internal Auditor, a publication of the Institute of Internal Auditors. Several of the above listed books, particularly the AICPA "Guidelines" and the Herbert book, include longer bibliographies, listing articles. Some articles have been gathered in two "compendium" publications of the Association of Government Accountants.