

SOFT CONTROLS: A Dallas/Fort Worth Perspective

The 1998-1999 Research Project
Conducted by The Dallas Chapter of The Institute of Internal Auditors

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**SOFT CONTROLS:
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Profiles of The Dallas Chapter IIA Research Committee Members

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OBJECTIVE:

- The objective of this project focused on *providing a service to our chapter members* by obtaining timely information on the issues of soft controls.
- With the mission of “*Progress Through Sharing*”, information was compiled to provide chapter members and other internal audit professionals with relevant benchmarking data related to auditing soft controls.

Scope:

- The scope of this project focused on determining the following from a Dallas/Fort Worth Perspective:
 - ⇒ Definition of Soft Controls.
 - ⇒ Reasons to Audit Soft Controls.
 - ⇒ Attributes of who is Auditing Soft Controls.
 - ⇒ Tools used to Audit Soft Controls.
 - ⇒ Timing and Scope of Soft Control Audits.
 - ⇒ Reporting of Soft Controls.
 - ⇒ Training for Soft Controls.
- Additionally, we explored the following questions:
 - ⇒ Do you think soft controls are just a passing fad?
 - ⇒ If you are NOT auditing soft controls, are there any specific reasons?
 - ⇒ Is your audit department using any Control Models?
 - ⇒ How do you educate your clients on soft controls?

Research Methodology

This paper is a compilation of the following resources:

- Current literature on the subject of soft controls. This included articles, books, and other publications, such as *Internal Control – Integrated Framework (COSO)*.
- Experiences of committee members and experts in the profession. We consulted with Dr. James Roth, author of *Control Model Implementation: Best Practices*, and Dr. Raymond Clay of University of North Texas.
- A survey of leaders in Dallas and Fort Worth Internal Audit Departments. We sent 333 surveys to Directors, Managers, and other Supervisors. We received 68 completed surveys back with over 70% of these auditing soft controls to some extent.

I. DEFINITION OF SOFT CONTROLS

a) TYPES OF SOFT CONTROLS

Objectives:

The primary objective of this section was to determine what “soft controls” are according to Dallas/Fort Worth Audit Departments.

Literature Review:

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines control in the *Internal Control – Integrated Framework* as:

“...a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.”(COSO, p.9)

COSO further describes the importance of people at all levels of the organization within the internal control structure with the board of directors as an important element. Most boards of directors rely on management to maintain a strong internal control system; however, the boards must reinforce controls with independent oversight. Based on COSO, the board or the audit committee should be asking the following questions to ensure proper oversight:

- “Is there a strong ethical environment and culture?”
- How does the organization identify and manage risks?
- Is the control system effective?
- Is there strong monitoring?”(Flaherty, p.6-7)

These four questions all deal with the concept of soft controls. James Roth, in his book *Control Model Implementation: Best Practices*, summarized the concept:

“If we are to render a professional opinion on internal control, COSO seems to imply, we must evaluate not just the “hard,” tangible control activities, but all the “soft,” intangible things management uses to control the organization. COSO tells us this includes things like:

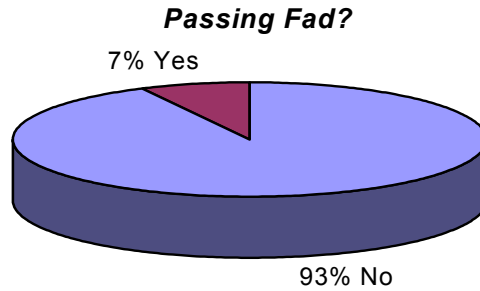
- People’s integrity and ethical values.
- Organization’s commitment to competence.
- Management’s philosophy and operating style.
- The understanding and management of risk.
- Communication.”(Roth-book, p.6)

I. DEFINITION OF SOFT CONTROLS (continued)

a) TYPES OF SOFT CONTROLS (continued)

Survey Results:

During initial discussions of this project, it was thought that not all participants had a clear definition of soft control. Therefore, the above concept summary by James Roth was printed on the survey so that all respondents would have a basis to complete the survey. From this, the respondents were asked if “soft controls” are just a passing fad.



Note that 7% (5 respondents) took the time to complete the survey and return it even though they considered it a fad. There was an overall response rate of 20% of all surveys mailed.

In an effort to refine the definition of soft controls, the following was asked: (Responses are listed starting with strongest agreement.)

<i>Survey Question: To what extent do you consider the following to play a role as a soft control?</i>	Total Respondents Average*	Respondents Auditing Soft Controls*#	Respondents NOT Auditing Soft Controls*#	Difference in Auditing and Not Auditing Soft Controls
People’s integrity and ethical values	4.7	4.7	4.7	-
Management’s philosophy and operating style	4.7	4.7	4.7	-
Organization’s commitment to competence	4.5	4.5	4.5	-
Communication	4.5	4.6	4.4	0.2
Leadership	4.5	4.7	4.1	0.6
The understanding and management of risk	4.4	4.6	4.1	0.5
Responsibility & Accountability	4.3	4.4	4.1	0.4
Control Environment	4.2	4.4	3.9	0.5
Training	4.1	4.2	3.9	0.3
Trust	4.0	4.1	4.0	0.1
Segregation of Duties	3.7	3.7	3.6	0.1
Reconciliations	3.6	3.5	3.7	(0.2)
Decision-Making Guidelines	3.5	3.4	3.6	(0.2)
Approvals/Authority Levels	3.5	3.6	3.3	0.3
Defined Relationships	3.5	3.6	3.3	0.3
Incentive Plans	3.4	3.4	3.3	0.1
Clients Performing Self-Audits or Quality Control Audits	3.3	3.3	3.2	0.1
Performing Control Self Assessment (CSA)	3.0	3.1	2.8	0.2
Other @	3.8	4.0	3.0	1.0

(Notes to chart on next page)

I. DEFINITION OF SOFT CONTROLS (continued)

a) TYPES OF SOFT CONTROLS (continued)

Chart Notes from preceding page:

- * Agreement shown is the average of the responses chosen on a scale from (5) “Strongly Agree” to (1) Strongly Disagree.
- # Responses were separated based on answers to various questions; 49 of the 68 Respondents (72%) are considered to audit soft controls and 19 of 68 (28%) not.
- @ Other included “employee empowerment” and “tone at the top”.

Comments:

- Most respondents agreed that some of the components of COSO could be interpreted as soft controls.
- “People’s integrity and ethical values” and “Management’s philosophy and operating style” were ranked the strongest as “soft controls”.
- Controls with more “hard” control connotations, such as segregation of duties and reconciliations, were ranked lower. However, from further analysis, over 50% of the respondents agreed or strongly agreed that segregation of duties and reconciliations are soft controls. This may indicate that some respondents in our survey may not have a good understanding of soft controls.
- Performing CSA’s were seen as neutral as a soft control in itself.
- When asked to describe soft control issues, one of the survey respondents commented that “By and large, breakdowns in soft controls are the root causes of breakdowns in "hard" controls.”

I. DEFINITION OF SOFT CONTROLS (continued)

b) EXTENT OF SOFT CONTROL REVIEWS

Objectives:

The primary objective of this section was to determine how the concept of soft controls is incorporated into the activities of the audit departments within the Dallas/Fort Worth area. The specific tools used are explored later in this paper; this section is only a review of the concept and approach. References to control models are in the next section.

Survey Results:

A question was asked to see how soft controls are incorporated into the traditional audit process. (Responses are listed from least extent to most extent.)

<i>Survey Question: To what extent do you consider that your department audits “soft controls”, based on your understanding of the term?</i>	Percent of Respondents Agree/Strongly Agree@	Percent of Respondents Neutral#	Percent of Respondents Disagree/Strongly Disagree^
We review soft controls as special projects separate from internal audits.	9.0%	14.9%	76.1%
We review soft controls during CSA workshops.	23.4%	10.9%	65.6%
We have implemented a control model, which incorporates the auditing of soft controls.	28.4%	22.4%	49.3%
We focus mainly on compliance with policy and procedures.	31.3%	29.9%	38.8%
We include in our audit programs questions or questionnaires that specifically cover soft control issues.	41.8%	28.4%	29.9%
During audits we attempt to assess soft control areas, but have no specific audit tools.	52.2%	19.4%	28.4%
We plan to increase our focus on soft controls in the future.	58.0%	30.0%	12.0%
We consider soft controls when developing the annual audit plan/schedule.	59.7%	11.9%	28.4%

The respondents chose from a scale of (5) “Strongly Agree” to (1) Strongly Disagree:

@ “Agreement” shown is the percentage of the responses of (5) “Strongly Agree” and (4).

“Neutral” shown is the percentage of the responses of (3).

^ “Disagreement” shown is the percentage of the responses of (1) “Strongly Disagree” and (2).

Comments:

- Soft controls are considered during stages of the audits, to a certain degree, including audit planning and developing audit programs.
- Over half of the respondents (52.2%) of the respondents agreed that they “attempt to assess soft controls areas, but have no specific audit tools”. The tools used are discussed later in this paper.
- From further analysis of the correlation of the respondents who are currently auditing soft controls to the response “We plan to increase our focus on soft controls in the future”, 53% of those auditing soft controls Agree or Strongly Agree (4 and 5) that they will continue in the future.

I. DEFINITION OF SOFT CONTROLS (continued)

c) CONTROL MODELS

Objectives:

The primary objective of this section was to review the use of control models to further explore the extent that soft controls are considered by the Dallas/Fort Worth area audit departments.

Literature Review:

Control models outline the components or criteria of an internal control structure. Most accepted control models include the concept of soft controls among the components as referenced above in section I(a) of this paper. Further comments by James Roth include:

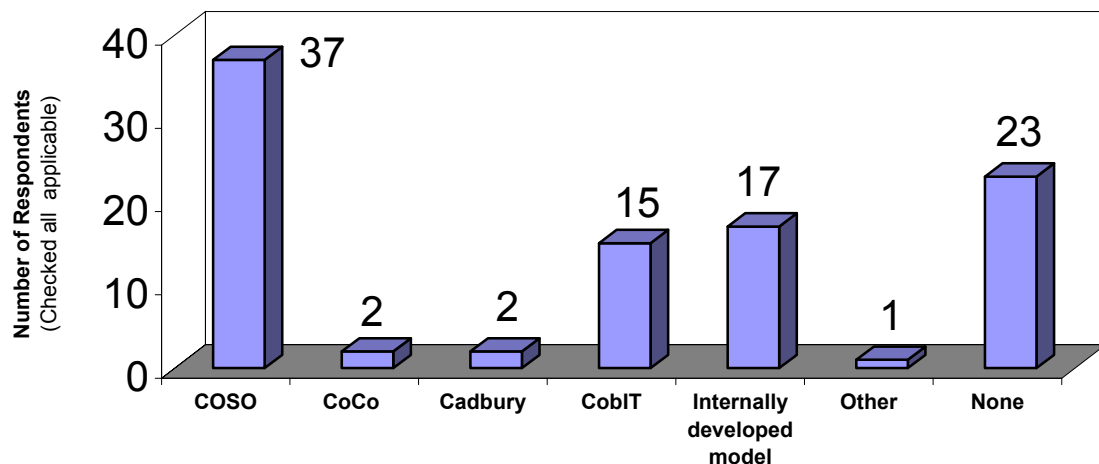
“...the control models COSO and CoCo, which provide the first authoritative definitions of what internal control is, were written at the time when employee empowerment was coming to the forefront. As a result, those models emphasize the importance of soft controls. If we intend to implement these models in our organizations, we must consider the types of controls that they present as essential.” (Roth-article, p.31)

In another article discussing the decision to audit soft controls and implementing a control model, the authors commented that “...many organizations have shied away from (COSO and CoCo) because of the challenges they present. Both documents clearly indicate that the keys to organizational effectiveness go beyond the tangible, measurable controls that have been the traditional purview of internal auditors.” (Gibbs/Gibson, p.34)

Survey Results:

Questions were asked as to which control models are being considered and/or have been implemented and how are the control models used.

Which Control Models?



“COSO” is *Internal Control Integrated Framework* issued in September 1992 by the Committee of Sponsoring Organizations of the Treadway Commission.

“CoCo” is *Guidance on Control*, issued in November 1995 by the Criteria of Control Board of the Canadian Institute of Chartered Accountants.

“Cadbury” refers to publications by the United Kingdom’s Cadbury Commission.

“CobIT” is the *Control Objectives for Information and Related Technology* published by the Information Systems Audit and Control Association (ISACA).

The “Other” response described the assessment of internal accounting controls as a risk factor within the risk assessment analysis.

I. DEFINITION OF SOFT CONTROLS (continued)

c) CONTROL MODELS (continued)

<i>Survey Question: To what extent has your department integrated or plans to integrate this control model in your work?</i>	Percent of Respondents Agree/Strongly Agree@	Percent of Respondents Neutral#	Percent of Respondents Disagree/Strongly Disagree^
The control model is the framework for our CSA workshops	35.0%	27.5%	37.5%
Our audit approach is structured according to the control model	61.9%	23.8%	14.3%
Our audit report is structured according to the control model	42.9%	21.4%	35.7%
The management throughout our organization has been educated on the control model	16.3%	18.6%	65.1%
The employees throughout our organization have been educated on the control model	14.0%	16.3%	69.8%
The control model is used as a reference in our work	40.9%	34.1%	25.0%

The respondents chose from a scale of (5) “Strongly Agree” to (1) Strongly Disagree:

@ “Agreement” shown is the percentage of the responses of (5) “Strongly Agree” and (4).

“Neutral” shown is the percentage of the responses of (3).

^ “Disagreement” shown is the percentage of the responses of (1) “Strongly Disagree” and (2).

In addition, for those respondents who have implemented control models, questions about the benefits of control models were asked:

<i>Survey Question: To what extent have you realized or have evidence of the expected benefits?</i>	Total Respondents Average* ^
Better recommendations	4.2
Better linkage of audit report items to control weaknesses	4.1
Greater audit efficiency	3.9
Better management understanding and ownership of control structure	3.9
Better communication with management	3.8
Compliance with regulations	3.5

* Agreement shown is the average of the responses chosen on a scale from (5) “Strongly Agree” to (1) Strongly Disagree.

^ There was only 1 respondent that implemented a control model and is not considered to audit soft controls based on responses to other questions, thus the “total” was used here.

I. DEFINITION OF SOFT CONTROLS (continued)

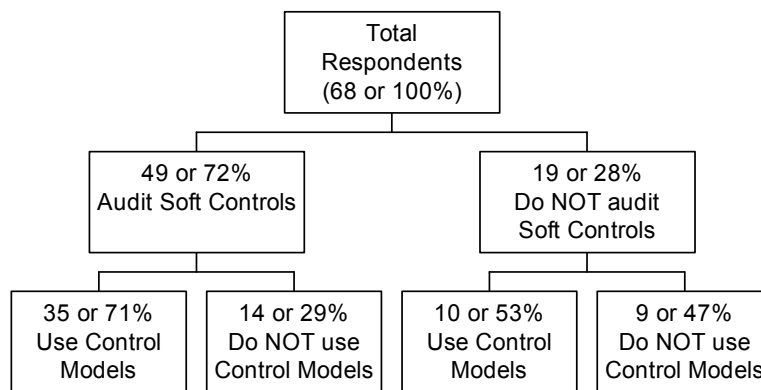
c) CONTROL MODEL (continued)

Comments:

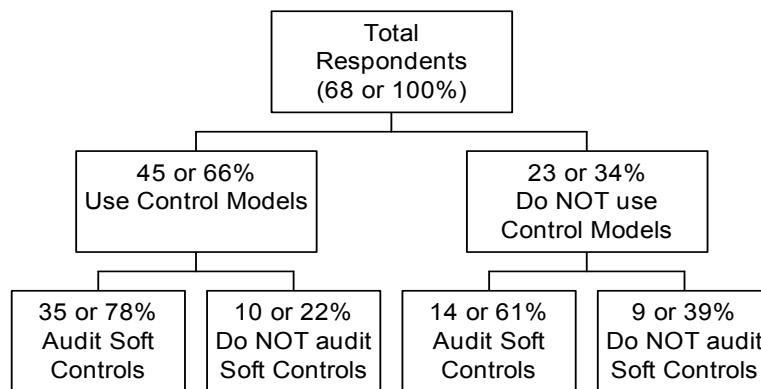
- From further analysis below, for those auditing soft controls, 71 % use a control model. However, some respondents (29%) consider themselves to audit soft controls without implementing a control model.
- Also from below, from a different perspective, for those using control models, 22% are not auditing soft controls.
- Education on control models is low at both the management level and throughout the organization.
- Benefits can and have been achieved with the use of control models. The most realized benefits of implementing control models relate to improved audit recommendations and understanding by management.
- The responses as to the benefits realized were similar to responses to a survey conducted by James Roth for his book. (Roth-book, p.78)

Further analysis on the correlation of respondents auditing soft controls and using control models:

For those auditing Soft Controls:



For those using Control Models:



II. AUDIT DEPARTMENT PROFILE

The overall objective of this section was to determine if there is a difference in the demographics, goals, activities, or organizations relating to the Audit Departments that are auditing soft controls and those that are not. Note that the research is biased toward the departments that are auditing soft controls, since those would be more likely to return this particular survey.

The following are the key questions determining if the respondents are auditing soft controls and why:

<i>Survey Question: If you are auditing "soft controls", what influenced you to start? (check all that apply)</i>	Total Responses#	Percentage of Total Respondents
Information from professional literature and articles	32	47.1%
Information from a seminar	18	26.5%
Suggestion from the Audit Committee or Senior Management	14	20.6%
Other @	18	26.5%

@ Other included the following comments: Own Experience or Judgment, New Auditors, Corporate Culture, Related Fraud, and FDICIA Compliance.

A total of 49 (72%) respondents answered this question, thus are considered as "auditing soft controls".

<i>Survey Question: If you are NOT auditing "soft controls", are there any specific reasons? (check all that apply)</i>	Total Responses#	Percentage of Total Respondents
Unfamiliar with appropriate tools or terminology	15	22.1%
Soft controls are too difficult to test	10	14.7%
Soft controls are not as important as hard controls	3	4.4%
Audit Committee does not want to review	2	2.9%
Other @	6	8.8%

@ Other included the following comments: Too Subjective, Too Political, Management does not want, and Do not consider the organization having related weakness.

A total of 19 (28%) respondents answered this question, thus are considered as "NOT auditing soft controls".

From the above, the presumption can be made that Audit Department leaders not auditing soft controls may not be reading the professional literature (22.1% not familiar with terms compared to 47.1% learned from professional literature). The "other" comments on both sides provide insights. The comments for not auditing soft controls are the stereotypical responses with a lack of familiarity. A couple of these respondents expanded their comments:

- "Too subjective; too difficult to "sell" any recommendations to management."
- "Too political/auditors not trained to evaluate soft controls. More appropriate for an industrial psychologist or behavioral psychologist."

II. AUDIT DEPARTMENT PROFILE (continued)

a) SURVEY DEMOGRAPHICS

Objectives:

The objectives of the Survey Demographics section were, first, to profile the audit departments in the Dallas/Fort Worth area and, second, to determine if there are differences between audit departments that audit soft controls and those that do not.

Literature Review:

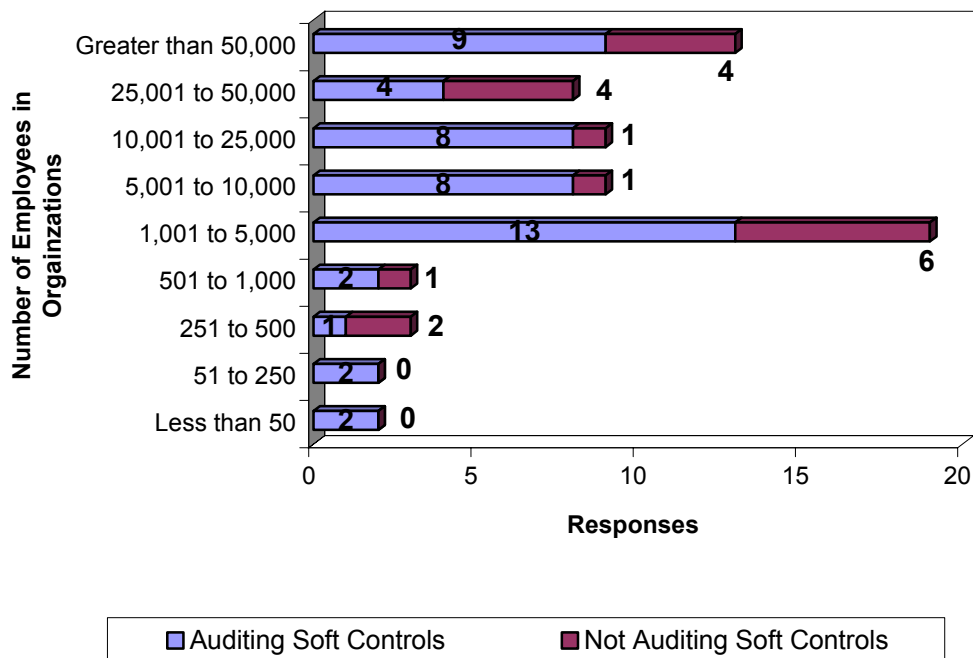
From reviews of literature, no mention was found that correlated demographics to those auditing soft controls. In other studies, surveys were usually sent to the larger companies since they were easier to identify. Our survey includes demographic questions that facilitate a comparison with those auditing soft controls.

Survey Results:

Each respondent was asked their organization's primary industry group. Dallas/Fort Worth has a large number of headquarters for national companies, including retail, telecommunication, oil & gas, manufacturing, and transportation. Also represented were the banking, insurance, restaurant, computer, government, health care, education, and utilities industries. The most represented industry was the wholesale and retail sector (18%). With the spread, no presumptions could be made as to industries auditing soft controls.

The sizes of the organizations for the respondents range from very small to very large. A few organizations had under 50 employees and 19% having greater than 50,000 employees, with 28% of the respondents in organizations with 1001 to 5000 employees. By reviewing the size and who is auditing soft controls, like the industry, the respondents are basically split among the categories.

Size of Organizations:

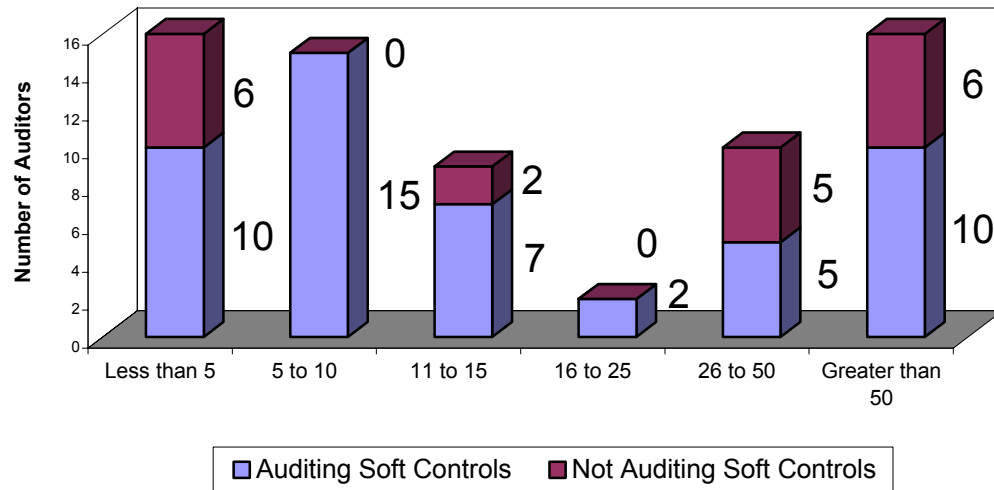


II. AUDIT DEPARTMENT PROFILE (continued)

a) SURVEY DEMOGRAPHICS (continued)

Also the respondents were split as to size of the audit departments.

Size of Audit Departments:



Comments:

- The industry, size of the organization, or size of the audit department are not determining factors of who is auditing soft controls.
- Of the respondents, all sizes of organizations are auditing soft controls.
- Of the respondents, just as many small audit departments are auditing soft controls as large audit departments (10 of each).
- These results regarding size may go against intuition; larger departments should have more access to the latest tools and techniques. However, the concept of soft controls crosses all boundaries.
- A word of caution, the response rate of the survey was 20%. The above demographics were not compared to the actual Dallas/Fort Worth business composition.

II. AUDIT DEPARTMENT PROFILE (continued)

b) AUDIT DEPARTMENT GOALS AND ACTIVITIES

Objectives:

The primary objective of this section was to further explore the differences between the Dallas/Fort Worth Audit Departments auditing and not auditing soft controls with a focus on the attributes of the respective departments.

Literature Review:

Many of the articles and books previously referenced included comments that the audit departments must keep up with the changes in management and the organization. According to James Roth, "If we still think our job is to evaluate compliance with policies and procedures, it leaves (internal auditors) nowhere. ...that's not what our organizations need. As managements move into empowerment modes, they need help with the transition... So (internal auditors') job, I think, increasingly is going to involve evaluating these soft, intangible areas." (Roth-article, p.31)

"Almost without exception, their initial fears about evaluating soft controls turn into enthusiasm for the benefits derived by their organizations and themselves." (Roth-book, p.2)

"Because 'soft' controls are subjective in nature, an outside observer using objective evidence cannot reliably evaluate them. For this reason, most evaluation practices involve a strong element of self-assessment. The guiding principle is that evaluating soft controls requires a partnership between auditors and their customers." (Roth-book, p.1)

Survey Results:

Overall questions were asked as to the focus or attitudes of audit departments:

<i>Survey Question: For your audit department, do you strongly agree or disagree with the following statements?</i>	Total Respondents Average*	Respondents Auditing Soft Controls*#	Respondents NOT Auditing Soft Controls*#	Difference in Auditing and Not Auditing Soft Controls
My department focuses mainly on compliance with policy and procedures.	2.9	2.9	2.8	0.1
My department has considered and/or implemented some new audit approaches in the last few years.	4.3	4.3	4.2	0.1
My audit department is more proactive than reactive.	3.9	3.9	3.9	-
My department performs value-added audits/ high impact audits.	4.0	4.1	3.9	0.2

* Agreement shown is the average of the responses chosen on a scale from (5) "Very Important" to (1) "Not Important".

Responses were separated based on answers to various questions; 49 of the 68 Respondents (72%) are considered to audit soft controls and 19 of 68 (28%) not.

Then, questions were asked as specific goals and activities of audit departments. Note that the results of these questions can be compared to the same questions asked on a prior survey conducted by the Dallas Chapter of the IIA in 1998. This comparison is for informational purposes only.

II. AUDIT DEPARTMENT PROFILE (continued)

b) AUDIT DEPARTMENT GOALS AND ACTIVITIES (continued)

<i>Survey Question: As to the goals of an audit department, do you strongly agree or disagree with the following statements?</i>	Total Respondents Average (Current)*	Respondents Auditing Soft Controls*#	Respondents NOT Auditing Soft Controls*#	Total Respondents Average* (Prior Year^)
Meet audit committee needs	4.4	4.5	4.4	3.9
Report status of proper internal controls	4.4	4.5	4.4	3.7
Provide information to the organization's decision-maker	4.2	4.1	4.5	4.2
Meet auditee/client needs	4.1	4.1	4.1	4.2
Facilitate Management's understanding of controls	4.0	4.0	4.1	4.0
Educate personnel as to proper internal controls	4.0	4.1	3.7	4.0
Report status of compliance with legal/organizational objectives	3.9	3.9	4.1	3.5
Facilitate change or innovations in the organization	3.9	3.8	3.9	4.4
Other @	4.4	4.6	3.0	-

@ Other included the following: Encourage innovation, Consultations, System Implementations, Joint venture audits of partners, and Use CSA/CRSA techniques.
(See additional notes to chart on next page)

<i>Survey Question: What do you consider to be the degree of importance of the various audit activities to you and your organization?</i>	Total Respondents Average*	Respondents Auditing Soft Controls*#	Respondents NOT Auditing Soft Controls*#	Total Respondents Average* (Prior Year^)
Operational audits	4.5	4.6	4.0	4.0
Systems audits	4.3	4.3	4.2	4.4
Business Risk Analysis	4.0	4.3	3.4	4.3
Management Consulting/ Management Advisory Service	3.6	3.8	3.3	4.1
Financial audits	3.5	3.3	3.8	3.0
Procedural compliance audits	3.5	3.6	3.4	3.1
Best Practices/Benchmarking	3.5	3.6	3.2	4.0
Fraud Investigation	3.4	3.6	3.0	-
Information gathering for management	3.3	3.3	3.4	3.9
Certify internal controls	3.2	3.2	3.0	3.2
Trainer/Facilitator on Internal Controls	3.1	3.3	2.7	3.8
Re-engineering Task Force	2.9	2.9	2.8	3.7
Due Diligence/Acquisition Reviews	2.9	2.9	2.9	3.5
Other self-assessment projects	2.6	2.8	2.3	-
Control Self-Assessments (CSA) workshops	2.5	2.6	2.3	4.1
Other @	4.5	4.5	0.0	-

@ Other included "FCPA Compliance".
(See additional notes to chart on next page)

II. AUDIT DEPARTMENT PROFILE (continued)

b) AUDIT DEPARTMENT GOALS AND ACTIVITIES (continued)

Charts Notes from preceding page:

- * Agreement shown is the average of the responses chosen on a scale from (5) “Strongly Agree” to (1) Strongly Disagree.
- # Responses were separated based on answers to various questions; 49 of the 68 Respondents (72%) are considered to audit soft controls and 19 of 68 (28%) not.
- ^ From 1997-1998 Dallas Research Project “*Internal Audit Today and Tomorrow: The Dallas/Fort Worth Metroplex Perspective*”. Questions asked were the same wording and similar format. Responses with “-“ were not asked in prior year.

Comments:

- Compliance issues are still focused on -- there is no one not doing compliance audits, but they are not the main focus (only 2.8 - 2.9 averages) for those on *either* side of the soft control auditing issue.
- More strongly focused on (4.0 - 4.3 averages), it would seem, is that every audit department be an innovator. At least, they all indicated a willingness to try new approaches, be more proactive, and collaborate with clients in process improvements, such as by value-added auditing.
- As for goals, traditional audit goals relating to the audit committee needs are considered the most important.
- As for audit activities, traditional activities, including operational audits and system audits, are considered the most important.
- Control Self-Assessment is ranked as lowest importance of the activities to the organization.
- Of interest, respondents auditing soft controls tended either to assign somewhat significantly more importance or the same importance to various audit activities compared to respondents not auditing soft controls. This may indicate attitude differences between the two groups.
- The comparison of the results between 1998 and 1999 vary to a certain degree. Assuming comparable responses, it is interesting that the more traditional activities have gained in importance over the prior year while CSA has decreased in importance.

II. AUDIT DEPARTMENT PROFILE (continued)

c) ORGANIZATION ATTRIBUTES

Objectives:

The primary objective of this section was to further explore the differences between the Dallas/Fort Worth Audit Departments auditing and not auditing soft controls with a focus on the attributes of the respective organizations.

Literature Review:

Again from the interview of James Roth, he outlines the changing face of management and how auditors should also change: “As managements move into empowerment modes, they need help with the transition... So (internal auditors) job, I think, increasingly is going to involve evaluating these soft, intangible areas.” (Roth-article, p.31) This thought process was the basis of some of the questions in this section.

Survey Results:

Survey Question: In the last few years, has your organization implemented, is considering, or not considering any of the following strategies?

	Respondents Auditing Soft Controls*#		Respondents NOT Auditing Soft Controls*#	
	Implemented or Considering (% of 49)	Not Considering (% of 49)	Implemented or Considering (% of 19)	Not Considering (% of 19)
Focus on Core Values	79.6%	14.3%	78.9%	15.8%
Value-Added Management	65.3%	24.5%	73.7%	26.3%
Employee Empowerment	73.5%	22.4%	78.9%	21.1%
Process Reengineering	79.6%	18.4%	84.2%	10.5%
Reducing Management Levels (e.g. flatten management)	69.4%	22.4%	78.9%	21.1%
Self-Directed Work Teams	61.2%	30.6%	57.9%	31.6%
Risk Assessment or Control Self-Assessment	75.5%	18.4%	73.7%	21.1%
Alignment by Strategic Business Unit	75.5%	18.4%	78.9%	21.1%
Other @	4.1%	0.0%	0.0%	0.0%

Responses were separated based on answers to various questions; 49 of the 68 Respondents (72%) are considered to audit soft controls and 19 of 68 (28%) not.

@ Other included “Best Practices” and “Merging to Grow”.

Comments:

- Basically, no conclusions can be made as to corporate culture and who audits soft controls; roughly, the same percentages of organizations, either auditing soft controls or not, have implemented or is considering these programs. This is contrary to the hypothesis made by the research team prior to the survey. The thought was that the more proactive the organization, the more proactive the audit department.
- Most organizations have implemented or are considering each of these current trends in management. The strategies used are intriguing: “Focus on Core Values”, “Employee Empowerment Process”, “Reengineering”, “Risk Assessment or Control Self-Assessment”, and “Alignment by Strategic Business Unit” are more related to soft control issues.
- Note, these are some of the most exciting organizing strategies around. They may involve significant risk of under-appreciated cuts of control activities, and reshaping all over the control environment landscape, without concomitant efforts in boosting control awareness and participation strategies to gain commitments in making the new looser structure work. In other words, management can go forward on these strategies with or without audit participation during the process.

III. AUDITS OF SOFT CONTROLS

The overall objective of this section was to determine how soft controls are audited by the Dallas/Fort Worth area audit departments. Each stage of the audit is discussed: planning, testing, and reporting. There are many resources and literature discussing these tools and methods, including COSO and the book by James Roth. Shown here is the Dallas/Fort Worth perspective with a total of 45 respondents answering questions in this section.

a) PLANNING

Objectives:

The primary objective of this section was to discover the approaches to soft control audits by Dallas/Fort Worth Audit Departments.

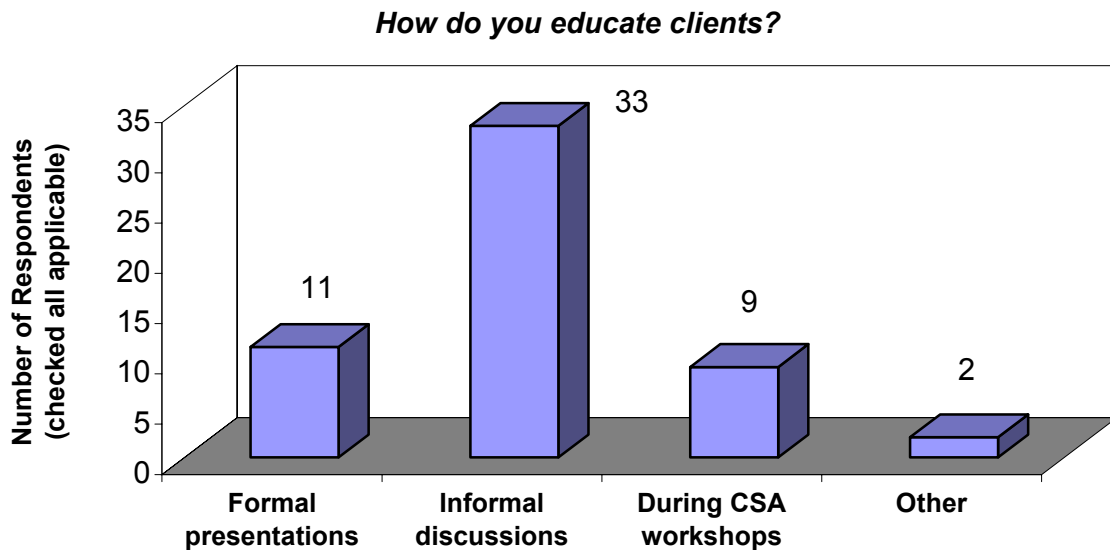
Literature Review:

Discussion from an article in *CSA Sentinel* set the tone for this section:

“Explaining the impact of these 'soft issues' to senior management proved very difficult without adequate examples. The typical response from senior management was that a [soft control] weakness - - a breakdown in communication for example -- does not have an impact on financial results and should therefore be dealt with by the human resources function. However, if one can demonstrate that [the impact] subsequently resulted in financial losses caused by a breakdown in [soft controls, e.g.,] communication, senior managers usually start listening and become committed to taking action.” (Reinecke, p.16)

Survey Results:

From comments and answers to various questions, it was clear that the first step in performing a soft



controls audit is education.

Other comments were “whitepapers, discussion memos” and “risk assessment workshops”.

III. AUDITS OF SOFT CONTROLS (continued)

a) PLANNING (continued)

A part of the education of clients is the understanding and commitment by senior management to the process. Below are a few of the related pitfalls to auditing soft controls described by our respondents:

- “Difficult to make management understand what soft controls are and how they can impact their area.”
- “Must be very specific with management in explaining what we are doing and what we hope to accomplish.”
- “Middle management and line personnel are often the most difficult to convince regarding the value of soft controls.”
- “Get buy-in first from client.”
- “Management must have confidence that the audit methodology is appropriate.”
- “Start with discussions with the Audit Committee and gather support at that level before implementing in audits.”
- “Contact well up front with client about participant confidentiality and expectations.”

In addition, from responses to questions related to deciding on who is to be audited in the area of soft controls, the overwhelming response was for the option “at all levels of the organization” (agreement average of 4.5 on a 1 to 5 scale). There was disagreement with options of “only at certain levels” (upper management, lower management, etc.).

III. AUDITS OF SOFT CONTROLS (continued)

b) AUDITING AND TOOLS

Objectives:

The primary objective of the Auditing and Tools section was to identify the actual methods used in auditing soft controls by Dallas/Fort Worth Audit Departments.

Survey Results:

A key question asked if the tools used differ depending on the controls being audited. We also explored details of how the tools are used.

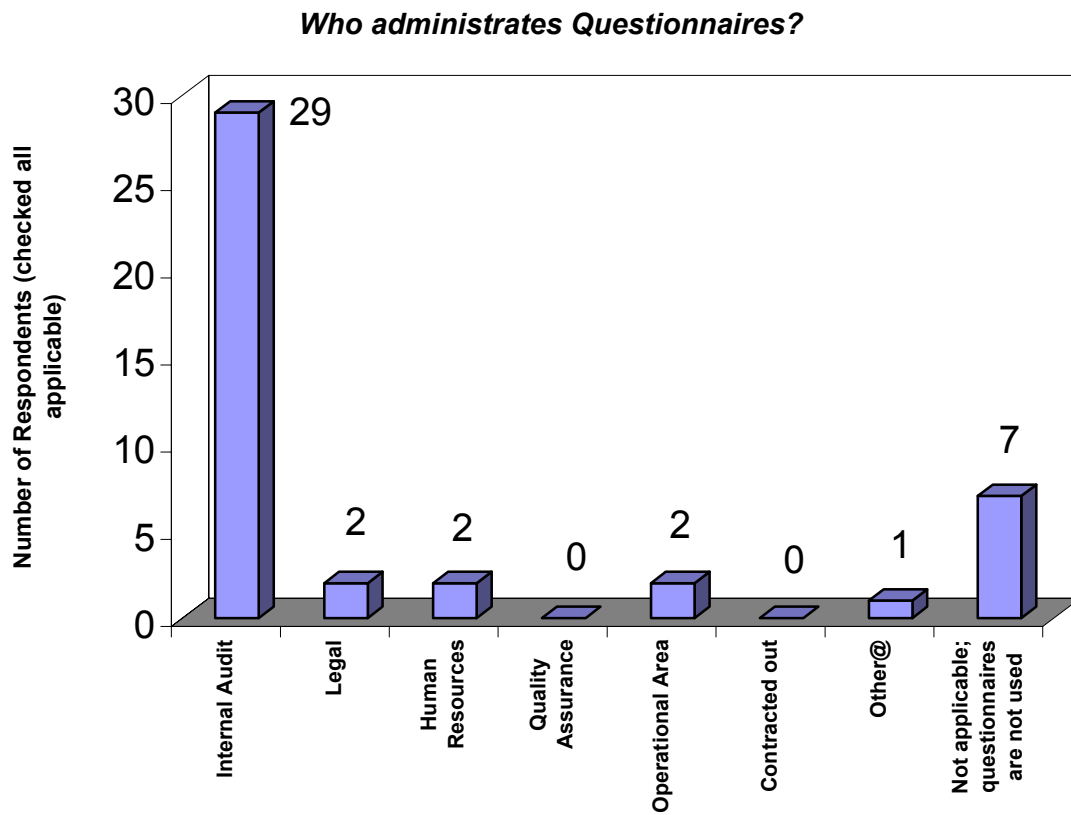
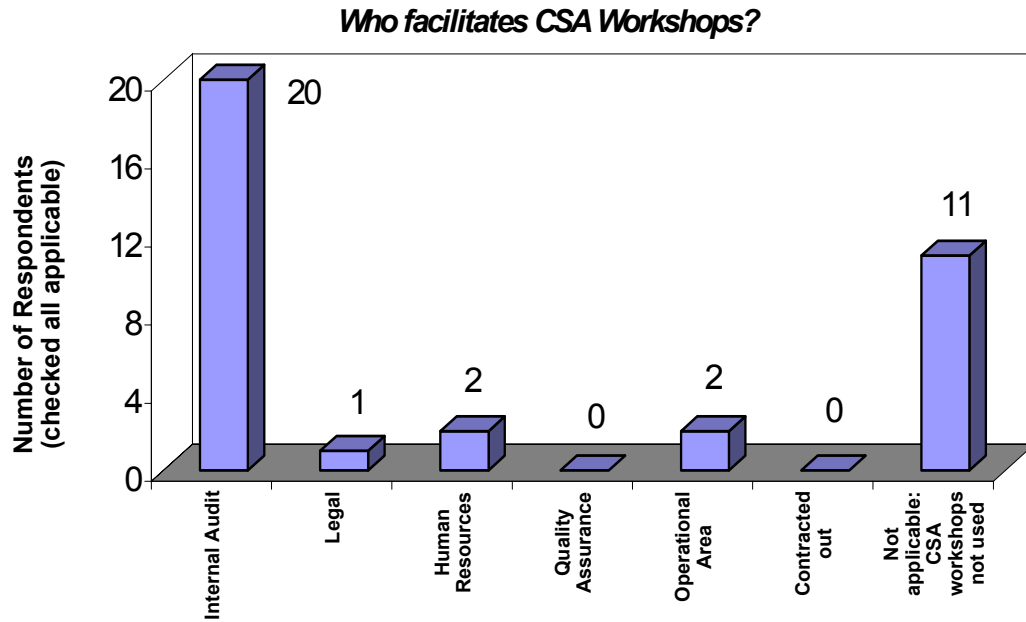
Survey Question: Of the different groups of tools, which ones do you use for the different "soft controls"? (check all that apply)

	CSA Workshop	Question -naire	Interview/ Observe	Substantive Testing	Other Tools @
People's integrity and ethical values	6	17	37	12	1
Organization's commitment to competence	6	12	32	8	1
Management's philosophy and operating style	8	12	27	3	2
The understanding and management of risk	10	19	28	5	1
Communication	8	16	34	11	1
Control Environment	9	20	29	17	0
Training	10	14	29	13	2
Incentive Plans	3	9	20	12	0
Decision-Making Guidelines	7	14	26	8	0
Trust	6	10	33	2	1
Defined Relationships	5	14	28	12	0
Leadership	7	8	36	5	1
Responsibility & Accountability	9	16	32	18	2

@ Other included the following: Education seminars, Accounting quality reviews, and Computerized programs in house.

III. AUDITS OF SOFT CONTROLS (continued)

b) AUDITING AND TOOLS (continued)



@ Other included "Accounting Services".

III. AUDITS OF SOFT CONTROLS (continued)

b) AUDITING AND TOOLS (continued)

Survey Question: Do you use the following tools to audit soft controls? (check all that apply)

	Total Number of Respondents
Interviews with employees	35
Observation	33
Risk Control Matrix	25
Questionnaires with open-ended questions	24
Traditional audits	22
Questionnaires with scaled questions	13
CSA workshops <i>with</i> anonymous voting, e.g. OptionFinder	5
CSA workshops with upper management	4
CSA workshops <i>without</i> anonymous voting	2
Computerized models/automated model evaluation software	2
Other @	2

@ Other included “Accounting quality reviews” and “Risks identified during the planning stage”.

Comments:

- It was a surprise to the research team that the tools used most frequently were subjective such as, interviews or observations.
- CSA, a method for understanding the soft controls within an organization is used by relatively few organizations responding to the survey.

III. AUDITS OF SOFT CONTROLS (continued)

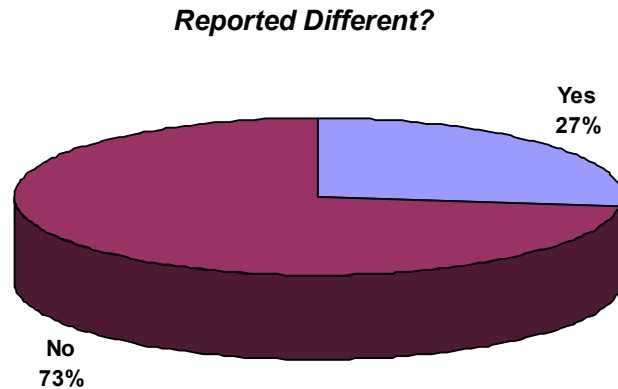
c) REPORTING

Objectives:

The primary objective of the Reporting section was to review the wrap-up methodology of soft control audits by Dallas/Fort Worth Audit Departments.

Survey Results:

The question was asked if soft control issues are reported in a different way from traditional audit findings.



Some the respondents expanded on the differences in reporting, as follows:

- “Included in CSA report, which is structured differently but still written.”
- “Audit reports in a non-judgmental way, de-emphasizing a formal opinion.”
- “Reports the status to the audit committee utilizing the audit staff’s findings.”
- “May be incorporated into other issues as causes, etc.”
- “Usually reported in discussion with the CEO rather than formal reports to the Audit Committee.”
- “Soft controls are often discussed only and not documented unless it is a significant matter.”
- “Depending on circumstances, most are communicated orally to operating unit and upper management.”

In addition, further questions were asked to clarify reporting:

<i>Survey Question: How do you report the results? (check all that apply)</i>	Total Number of Respondents
Formal written report	33
Informal discussions	16
Oral presentation to management	15
Included in CSA report	6

III. AUDITS OF SOFT CONTROLS (continued)

c) REPORTING (continued)

<i>Survey Question: What is reported as far as results? (check all that apply)</i>	Total Number of Respondents
Issues only	24
Summary of responses	20
Action plans	21
Trends	11
Survey results only	6
Other @	1

@ Other included "Depends on results".

Comments:

- The majority of companies (67%) include the results of their audit of soft controls in a formal written report.
- Informal and oral presentations are becoming popular for reporting the results of audits of soft controls.
- Reports tend to convey a summary of responses, trends and action plans.
- However, a sizeable number of companies only report issues noted in their audit of soft controls, without including a plan of action to resolve issues identified.
- Note that from additional questions asked, there was basically no difference between the method of reporting audits of sensitive areas, such as ethics, when compared to reporting of other soft control audits.

III. AUDITS OF SOFT CONTROLS (continued)

d) TRAINING

Objectives:

The primary objective of this section was to explore the emphasis that Dallas/Fort Worth Audit Departments will put on training on soft controls in the future. In addition, the results will benefit the local IIA Chapter training programs.

Survey Results:

Almost half of the respondents expect to increase training of their staff in regards to soft controls in the next year.

<i>Survey Question: If more training is considered necessary, in what areas do you expect to need training? (check all that apply)</i>	Total Number of Respondents
Tools and Techniques	39
Control Models	27
Introduction to terminology, definitions, benefits, etc.	24
CSA Workshops	21

<i>Survey Question: If more training is considered necessary, how do you expect to train? (check all that apply)</i>	Total Number of Respondents
Send staff to training/seminars	37
Educate current staff internally	20
Self study or staff obtain training on their own	16
Hire staff with those skills from outside the organization	6
Hire staff with those skills internally	4
Other @	2

@ Other included "Outside consultant to train staff" and "Utilize reference material".

Comments:

- Companies believe that training is essential to effectively audit soft controls.
- Training is needed in all aspects of soft controls. However, training on tools and techniques for auditing and evaluating soft controls is the most needed training.
- Over 60% of respondents will either send staff to outside training or hire staff with required skills.

**SOFT CONTROLS:
A Dallas/Fort Worth Perspective**

CONCLUSION

Auditing soft controls is a frequent topic in current professional literature, articles, and seminars. Within the Dallas/Fort Worth area, many audit departments are specifically auditing soft controls. Of the respondents to the survey, 49 or 72% considered themselves to be auditing soft controls; however, from the varying definitions of soft controls provided by the respondents, this may not be an accurate reflection of the actual auditing of soft controls. There still appears to be a need for additional education of what are soft controls.

The objective of this project was to explore auditing soft controls for Dallas/Fort Worth audit departments. It was discovered that those auditing soft controls differed. The industry, size of the organization, or size of the audit department are not determining factors of who is auditing soft controls. Some have control models and others not, even though most have found benefits from using the control models.

The approaches or methods used are generally subjective in nature. Half of the respondents agreed that they “attempt to assess soft controls areas, but have no specific audit tools”. Control Self-Assessment workshops are only used by a few departments. Interviews/observations are the most common methods used. Articles in the *Internal Auditor* and books on best practices describe techniques to make interviews more objective in nature to improve the audit evidence (Gibbs/Gibson, Ratliff/Brackner, Roth-book). However, training on all tools and techniques for auditing soft controls has been identified as the most needed training areas.

Below are some of the comments from the Dallas/Fort Worth survey respondents when asked to list any pitfalls to auditing soft controls:

- “Difficult to make management understand what soft controls are and how they can impact their area.”
- “Middle management and line personnel are often the most difficult to convince regarding the value of soft controls.”
- “Management must have confidence that the audit methodology is appropriate.”
- “Changing the expectations mind set for the auditee has been very difficult. While this is a new approach for the company, they don't like change and prefer to hear only exceptions to the processes tested.”
- “Evaluating soft controls requires employees to have a high level of trust with the Audit Department. It is a slow, gradual process in a tightly run organization. Be patient and take heart in the small changes. Look continually at your reporting process to include more and more COSO concepts.”
- “Need to support results with hard evidence.”

In conclusion, from responses of those in the survey that the internal auditing profession sees auditing soft controls as something that will stay – not a passing fad. We as professionals must address items such as "people's integrity and ethical values, "the organization's commitment to competence, "management's philosophy and operating style", "understanding and management of risk", and "communication".

**SOFT CONTROLS:
A Dallas/Fort Worth Perspective**

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**SOFT CONTROLS:
A Dallas/Fort Worth Perspective**

PROFILES OF THE DALLAS CHAPTER IIA RESEARCH COMMITTEE MEMBERS

Lynn Allsup, CPA, CFSA, MBA – This was Lynn’s third year on the Research Committee and first time to Chair. Lynn is an Operational Audit Director at Winterthur Swiss Insurance where she is responsible for managing audits of insurance subsidiaries in North America. Prior to this, she held positions of increasing responsibility at KPMG Peat Marwick. Lynn earned her MBA from The University of Texas at Arlington and her bachelor of science degree from Oklahoma State University. She recently obtained the designation of Certified Financial Services Auditor.

Mary Beth Goodrich, CPA, CIA, MBA - Mary Beth was the Research Committee Co-Chairperson in 1997 and continued as a member this year. She has served as Chairperson or committee member of several committees in The Dallas Chapter IIA and was a Board Member of The Baton Rouge Chapter IIA. Mary Beth is an Auditor and Control Consultant for the Credit Card Business Unit of The Associates’ Corporate Audit Department. Prior to this position, she was an Advanced Auditor at EDS. Mary Beth earned her MBA with a specialization in Internal Audit from Louisiana State University (LSU) and her bachelor of science degree from McNeese State University. She currently serves on LSU’s Internal Audit Advisory Board.

Nancy Hollis, CPA, CMA, MBA – Nancy joined the Research Project Committee this year. She currently works at The Associates as Director of Planning and Reporting for the Corporate Audit Department. Before joining The Associates, Nancy held various positions in the Controller’s Department at Atlantic Richfield Company. She played an active role in integrating CSA in many different areas of ARCO and contributed to the book *Control Self-Assessment: Making the Choice*. She has also taught accounting courses at the college level. Nancy earned her MBA from the University of Texas at Arlington and her BBA from Texas Christian University.

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

Silvester Smith, CIA- Silvester is the newest member of the Dallas Chapter’s Research Committee. He is a senior auditor at Texas Utilities where he performs operational audits for the Texas Utilities’ Service Company. Silvester was previously a member of the Fort Worth Chapter where he served on several committees including the Certification Committee. While serving as chairman of the Certification Committee, he worked closely with the Dallas Chapter to co-sponsor a joint CIA review seminar. Prior to joining Texas Utilities, Silvester was a senior auditor with the Dallas/Forth Worth Airport Board. Silvester earned his bachelor of science degree in accounting from Jackson State University in Jackson, Mississippi.