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# Experiential Learning for the Internal Auditing Student: An Internal Control Project

Mary B. Greenawalt and Sheila Foster-Stinnett

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In recent years there has been a marked growth in the number of colleges and universities offering internal audit coursework. Demand is increasing for programmes of study which produce students ready to stride forth into the internal auditing arena well-equipped with the knowledge and skills needed to compete successfully in this expanding, dynamic field.

## Success Factors for Future Internal Auditors

An increasing amount of research is being conducted regarding the factors that are perceived to influence the success of future internal auditors and how students can best be helped to develop those skills. Numerous studies have pointed up particular skills which, in addition to a thorough grounding in technical knowledge and theory, seem to be of primary importance to students seeking successful entry into the field of internal auditing.

In a recent study participants ranked aspects of college preparation in the order of their perceived importance to

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success as an internal auditor. The top six areas for preparation of future internal auditors were: "good interpersonal skills, good report writing skills, understanding of basic audit theory, understanding of basic audit procedures, good oral communication skills (and introductory knowledge of internal auditing" [1].

Results of a 1989 survey of audit directors showed that 91 per cent considered written communication skills and 84 per cent deemed oral communication skills essential characteristics of a successful internal auditor [2]. One director made the following plea, "...Please don't over-emphasize the technical; I can provide most of that. What I can't provide in a business environment is human resources skills and communication skills. It's too late by the time I get them" [2, p. 25].

A survey of 102 internal auditors found that they endorsed a college experience that emphasized a practical, operational approach with the use of practical experience over the traditional lecture approach in order to bring the necessary realism into the classroom setting [3].

The Accounting Education Change Commission emphasized the importance of communication skills, intellectual skills, interpersonal skills, and the ability of students to learn independently in its statement, *Objectives of Education for Accountants* [4].

The Big Eight accounting firms in their joint statement, *Perspectives on Education: Capabilities for Success in the Accounting Profession*, have called for educators to give special attention to communications skills, to create and employ more interesting and effective teaching techniques, and to employ more team projects with students.

A study of New Zealand internal and external audit executives found that those active in the area of auditing believed that, in addition to the traditional accounting and auditing principles and practices which form the core of most programmes, thinking skills such as creative thinking and independent learning skills should be taught [5]. Additionally, (and not unlike the lament raised by so many educators in all areas) they believed that students needed to learn in greater depth rather than gearing their learning toward merely passing an exam. These audit executives identified a list of success factors which they felt educational institutions were primarily responsible for instilling in prospective auditors. Among these factors were communication skills, audit expertise, human relations skills, and analytical thinking skills.

## Experiential Learning in Internal Auditing

Experiential learning has become a popular phrase with many educators in recent years. The idea that a "hands-on" learning experience may be more memorable, may

bring about a deeper understanding, and may have a more lasting benefit to college students has met with a favourable response on many college campuses. Internal auditing is an area that lends itself readily to this type of learning experience; recent studies and writings support these ideas.

Several experiential-oriented alternatives to the traditional lecture and textbook methods of teaching auditing have been suggested. Among those that have been tried with success are:

- the use of cases which serve as illustrations of real-world internal auditing problems;
- the use of guest lecturers who are internal auditing practitioners;
- simulated practice;
- on-campus internal audit projects;
- internship programmes.

Each of these methods has been an attempt to bring about a more realistic learning experience for the student (see, for instance, [6-10]; see [11] for a further review of the methods). Each of these methods also has the advantage to a greater or lesser degree of requiring the student to utilize communication, thinking, and interpersonal skills that might otherwise be neglected or given less attention in the traditional classroom setting.

Cases provide students with the opportunity to interact with "real-world" auditing problems. Cases, however, do not generally allow students to interact with individuals serving in the role of audit clients from whom additional information regarding the problem may be gleaned through the use of interpersonal and communication skills.

Having guest lecturers offers students an opportunity to exercise communication skills through interaction with a live practitioner in a question-answer exchange. While guest lecturers provide a unique insight into their experiences as internal auditors, rarely are they able to provide students with the opportunity to apply a "hands-on" approach to real auditing problems.

Simulated practices, although usually of a very short time duration, give students the opportunity to interact with both live "audit clients" and real-world audit situations. This method has the additional advantage of requiring students to use communication, interpersonal, and intellectual skills as they work with their team members to attempt to solve audit problems in a largely unstructured environment. However, because of the extensive time and training required of those playing the roles of audit clients, simulated practice experiences are available for relatively few students.

Internship programmes in which students are employees (paid or unpaid) of internal auditing departments probably

have the potential to be the most realistic and the most extended opportunity to apply what has been learned in theory in a true "hands-on" situation. Of course, the measure of success will differ from one internship to another depending upon the mix of student, advisor and company. For many students, however, there is no time or place in their programme of study for a full internship programme.

On-campus internal audit projects, such as those in which student teams perform some portion of an audit of a university entity with the co-operation of the university's internal auditing department, provide students with the challenge of working as team members in a real-world situation over a longer period of time than the simulated practice. Such projects provide students with ample opportunity to exercise their organization, communication, and interpersonal skills.

Securing the co-operation of university administrators is a necessary prerequisite for utilizing this type of project in the classroom.

### The Internal Control Project

This article describes an internal control project for internal auditing students which not only emphasizes the technical knowledge that the internal auditor needs but also requires the student to utilize to a healthy extent critical and analytical thinking skills, written and oral communication skills, and interpersonal skills.

This project emphasizes control because of its fundamental role in internal auditing. As the *Statement of Responsibilities of Internal Auditing* phrases it, internal auditing is "a control which functions by examining and evaluating the adequacy and effectiveness of other controls" [12]. According to Lawrence Sawyer, the control system is the "open sesame" that allows internal auditors to gain access to operating areas which may be highly technical subjects [13]. Students, even those with little or no experience in business, may use this "open sesame" to gain knowledge of and insight into totally new environments.

This internal control project is a modification of one initially designed for and successfully employed in undergraduate auditing classes [11]. The following is a description of that project as adapted specifically to the practice of internal auditing. (See the Appendix for a sample handout describing the project.)

Each team of students is responsible for obtaining the co-operation of a local business or organization to serve as an auditee (see Table I). The teams are charged with the task of obtaining an understanding of the internal control system of either the client's revenue or expenditure cycle. The team's written report consists of three parts:

**Table 1.** *Examples of Auditees*

Athletic shoe store	Florist
Auto repair shop	Cinema
Campus bookstore, laundry, newspaper, and printshop	Office supply distributor Pizza restaurant
Concrete supply company	Property agency
Daycare centre	Record and tape store Restaurant
Department store	Veterinary surgeon
Fast-food restaurant	Video rental store

- (1) Documentation of the understanding of the internal control system by means of a narrative, a flowchart and an internal control questionnaire.
- (2) An internal control review matrix with the following categories:
  - Audit objectives
  - Results of internal control review
  - Risks (nature and seriousness)
  - Appropriate control methods and types
  - Auditor's evaluation.
- (3) Additional audit objectives.

Normally, the internal auditor evaluates the control systems based on tests of the system. However, because of the time constraint for students to complete the project and data availability considerations, the basis for auditing judgements made by the students must generally be limited to information obtained in their inquiries and in their document reviews.

Working around the schedule of the business owner or manager, the team of students must be well prepared in advance in order to obtain the needed information within the limited amount of time made available by the auditee. The teams are given the independence to direct their own project; the team members decide what information is to be secured, who will gather the information, how the information will be gathered, and how it will be written up.

The last step of the project is an oral presentation of the team's findings to the entire internal auditing class. Team members must work together in order to provide an effective presentation. Classmates and the instructor may question the team members regarding their findings and their evaluations of those findings.

Because confidentiality is always a concern of businesses, the importance of holding all information in strict confidence is stressed prior to the beginning of the project. It is not necessary for students to have access to financial accounting data for this project, which may encourage prospective auditees to participate. Students are reminded during the classroom presentations of the confidentiality of the information being discussed.

## Utilization of Skills by Students

This "hands-on" project requires the students to employ analytical thinking, interpersonal and communication skills to elicit information from their auditees. The students may have to deal with situations, for instance, where the auditee may be available for only brief periods of time or, alternatively, may provide much irrelevant information which must be sifted through in order to extract the necessary bits of information. Working in audit teams, the students find it necessary to utilize their often underdeveloped interpersonal and organizational skills to ensure that each member of the team performs the duties assigned and that the project is completed in a timely and professional manner. The project requires the student to use written skills to document their findings regarding the client. In addition to their importance in the interview process, oral communication skills must be employed in order to present the findings of the audit team to the rest of the class.

## Advantages of This Project Approach

The advantages of this type of project are numerous. The students must both have and use a background of auditing theory in order to complete the project successfully. Perhaps more importantly, at least based upon the published findings of the studies quoted earlier, students are required to use oral communication, written communication, interpersonal, and independent learning skills. Furthermore, these skills are being tested in a "real world" context where students are encouraged to act with professionalism. All of these skills are ones that have been repeatedly identified as important by those already engaged in successful careers in internal auditing.

One comment was made repeatedly in the students' evaluations of a similar project assignment used by the authors[14]. Throughout the project, whether working with group members in deciding on how to divide the work load, or interviewing the auditee, or making their presentation, the students appreciated the opportunity to act and to be treated in a professional manner. More than merely being co-operative, the businesses welcomed the students. Even though the students did not have a great deal of experience, the owners or managers appreciated the teams' interest in and sincere evaluation of their businesses. This appreciation showed up in the attention the student team members gave to their work and in the quality of the end product.

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#### **Appendix. Internal Auditing Project: Internal Control System. Understanding, Documentation and Assessment**

The second general standard of the *Standards for the Professional Practice of Internal Auditing* states that:

The scope of the internal audit should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities.

In this project you will assess the internal control system of some portion of an organization as a basis for planning an audit. The objectives of the project are to:

- (1) Provide students hands-on experience in gaining an understanding of the internal control system of an organization.
- (2) Have students document their understanding of the internal control system by alternative methods such as narrative, flowchart, and internal control questionnaire.
- (3) Provide a real-world context for making audit judgements relating to the assessment of internal controls, risks, and audit objectives.

- (4) Allow students to experience working on a team basis, as practicing internal auditors do.

The grade for the project will be determined as follows:

Written report:	
Content	60
Communications quality	20
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Classroom presentation:	80
	20
	-----
	100 per cent

Groups or teams will consist of three or four members, as assigned by the instructor. The grade for the group determines the grade for each team member. Possible exception: If evidence indicates that a team member has performed little or no substantive work on the project, that person may receive no credit for the project or a lower grade than other team members.

*Client selection.* In order to carry out this project your group must obtain the co-operation of a business or non-profit organization (your employer, a business you patronize, a church or charitable organization, for example). Organizations with very simple recordkeeping, such as those which do not maintain a set of books (journal and ledger) are not appropriate for this assignment. For more complex organizations, it may be sufficient to review a subset of the revenue or expenditure cycle.

Group members are responsible for initiating the contact with a prospective auditee organization. To avoid multiple requests by different groups to the people in these organizations, you should preselect your auditee on a sign-up sheet prior to any contact being made.

*Note:* Please keep in mind that client information is confidential. While the information that your group obtains will be the basis for written and oral reports in this class, disclosure of information outside that setting is not appropriate. In addition, note that it is *not* essential that you see financial statement information in the process of gaining an understanding of the internal control structure.

Detailed instructions:

- (1) Discuss in your group how you will organize (assign responsibilities) to complete this project in a suitable format.
- (2) Select the organization to be your prospective auditee. Each group should select a different organization (first-come, first-served). Be sure to indicate your selection on the sign-up sheet before an initial contact to the organization is made. If co-operation is not obtained from an organization, repeat the selection process.
- (3) Select the area of the organization to be reviewed. Unless special clearance is obtained from the instructor, this should be either:
  - the revenue cycle or
  - the expenditure cycle.
- (4) Schedule and conduct interview(s) to obtain an understanding of the internal control system of the client's revenue or expenditure cycle. Remember that your auditee is providing you with a valuable resource

— his or her time! Be professional in carrying out the interview process.

Chapter 4 in Lawrence Sawyer's auditing textbook provides helpful hints about planning and carrying out an interview of this nature.

- (5) Your written report should consist of three parts:
- Documentation of your understanding of the internal control system;
  - An internal control review matrix;
  - Additional audit objectives.
- (6) *Part 1:* Document your understanding of the internal control structure in the following three ways:
- A narrative description
  - A flowchart
  - An internal control questionnaire.

The narrative description should include a brief description of the auditee's type of business or organization in addition to pertinent information about the revenue or expenditure cycle.

The internal control questionnaire should be tailored to the circumstances of the auditee. You may either develop it entirely or modify one from published sources.

- (7) *Part 2:* Document your evaluation of the internal control system using an internal control review matrix.

Unlike a real audit, these conclusions will be based only on your inquiries. Since you are not required to conduct walkthroughs or tests of controls except, perhaps, inspection of documents, your conclusions cannot be based on the results of such tests.

The internal control review matrix should have five columns with the following headings:

- Audit objectives;
- Results of internal control review;
- Risks (nature and seriousness);
- Appropriate control methods and types;
- Auditor's evaluation.

An example and discussion of an internal control review matrix can be found in the internal auditing textbook by Ratliffe, Wallace, Loebbecke and McFarland which is published by the Institute of Internal Auditors.

- (8) *Part 3:* In addition to the objectives which you develop and discuss in the internal control review matrix, develop at least two each of operational and compliance audit objectives which are applicable to your auditee.
- (9) The report should be typed or printed on a word processor. There is no page limitation; however, be concise in your writing. The flowchart may be computer-produced or hand-drawn using a template. A flowchart on a single large page is generally easier to read than one on multiple unattached sheets. Similarly, the matrix may be wider or longer than a single sheet so that all of it can be viewed at once.
- (10) Include as an appendix to the report a description of how the project team was organized and functional on the project. As a part of this appendix, each group member should prepare a one-page evaluation which addresses the following questions:
- Was the project beneficial as a learning experience? Why or why not? Elaborate.
  - Would you recommend that future classes be given this assignment? Why or why not? If so, what would you change about the assignment?

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Mary B. Greenawalt teaches in the Department of Business Administration at The Citadel, The Military College of South Carolina, Charleston, and Sheila Foster-Stinnett is a PhD student at the Virginia Polytechnic Institute and State University, Blacksburg, Virginia, USA.

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