

# Risk Insights

## Sound Planning

Precedes Effective Annual Internal Audits



**INTERNAL AUDIT PLANNING** is built from the annual risk assessment and related risk response plan and incorporates the objectives of the internal audit function charter. That development of the internal audit function reflects the priorities and principles incorporated into the internal audit strategy, which serves as a foundation for all internal audit activity.

Internal audit planning is conducted annually and includes monitoring significant financial reporting and operational processes that pose high to moderate risk. Based on updated organizational and process-level risk assessments, planning also acknowledges new potential risks posed by various changes that occurred within the past year or are anticipated for the current year.

### **Incorporating Annual Risk Considerations**

**RISK-BASED CONSIDERATION CHANGES** will include the integration of a new acquisition or a change in organizational structure. Such a transition brings new governance and financial reporting requirements. That entails implementing new functions and processes to support those requirements. During the implementation, it is often identified that the new requirements may not have the needed coverage of controls or receive sufficient attention, placing the organization at risk for noncompliance. Circumstances will vary by company, but there are some common conditions to consider.

Installing major IT systems requires extensive prior planning and testing of new hardware and software to ensure that various functions and interfaces work properly. Established processes must be revised to fully capitalize on the capabilities afforded by those new systems. Existing change management policies and procedures may not address every difficulty that can arise when making such a migration.

Over time, individuals in key positions acquire knowledge and insight that does not always transfer quickly to the people who replace them. Someone working in a crucial, newly-created position also faces a formidable learning curve. Such scenarios present the possibility that a critical responsibility may be overlooked or that a significant error in judgment may occur.

Organizations undertake reengineering and restructuring efforts to operate more efficiently and to focus more effectively on business strategies. Those transformations require devising new processes for various functions and defining new roles and duties for individuals and business units. With attention focused on making those transformations, risks can go unrecognized or unaddressed.

## Risk Insights: **Sound Planning**

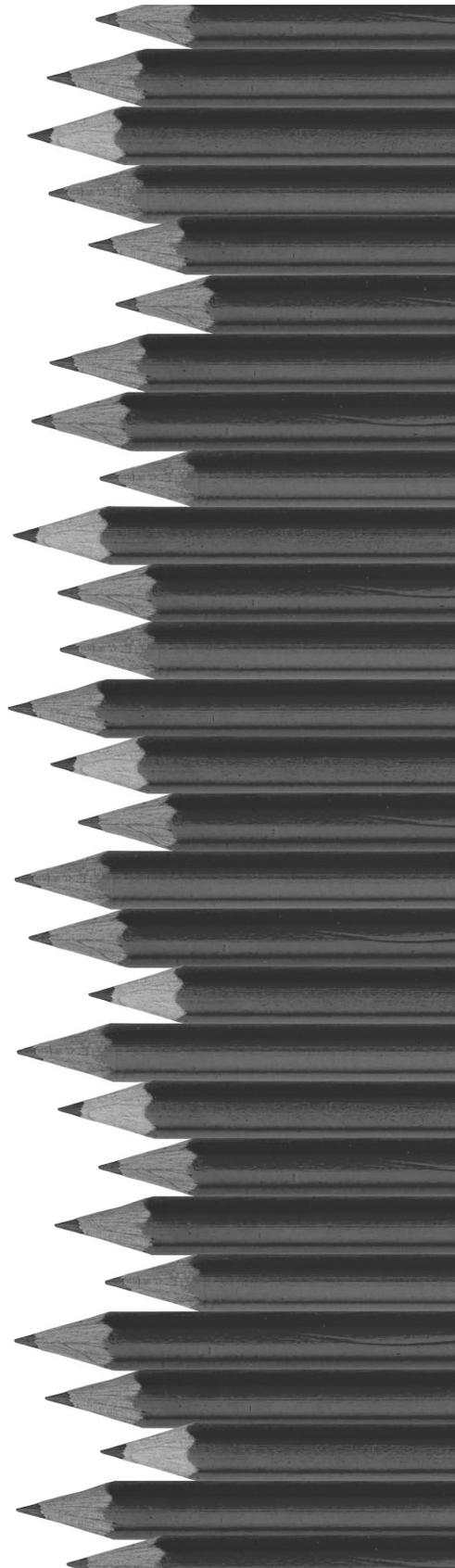
Prototype testing, market research and other planning efforts seek to reduce the uncertainty that accompanies the introductions of new products or services. Unanticipated difficulties in production or delivery can still arise. Defects not recognized in previous testing may become evident following customer purchases. Widespread marketplace acceptance cannot be guaranteed either. All of those factors make such introductions a higher concern for risk.

The opening of a new facility likewise presents potential risks. Managers may discover that building configurations and equipment installations are incompatible with actual workflows and needs. New facilities are also typically staffed with large numbers of recently hired employees that are not as adept in resolving problems as more seasoned workers. Those and other concerns may not surface until a new facility becomes operational.

“The annual internal audit plan **acknowledges** the **potential threats** posed by changes that occur throughout the year.”

As we have seen in recent years with increased regulation, compliance requirements do not remain static either. Each year brings revised requirements for various industries and types of organizations — revisions that present risk of noncompliance. The annual internal audit plan acknowledges the potential threats posed by those and other changes that occur throughout the year. The plan is usually prepared and presented to management for pre-approval during the same time as the organization’s annual budget. The audit committee will receive the proposed internal audit plan for the year and evaluate it based on their understanding of the organization’s operating strategies and risk profile. The internal audit plan will coincide with the annual budget and the strategic initiatives of the organization to ensure that risks are managed and objectives are met.

With each annual plan, the internal audit function advances efforts to assess and monitor risks associated with asset protection, loss prevention and compliance throughout the organization. Knowledge gleaned from internal audit activities enables the board of directors and management to address emerging risks and to mitigate any risks deemed unacceptable with the entity’s risk appetite.



### Determining the Scope for Internal Audit Planning

**THE RISK-RATED INTERNAL AUDIT UNIVERSE** is the basis for the risk response plan which includes internal audit as a method of monitoring risk. The risk response plan will consider the appropriate frequency of necessary internal audit activity. Some items, based on their risk ratings, may require attention every year while others only once every three years. The annual internal plan incorporates the process areas and significant activities scheduled for evaluation that year.

“Any **new risks** identified in updated risk assessments **are considered** for the annual internal audit plan.”

Any new risks identified in updated risk assessments are considered for the annual internal audit plan. The results of past annual audits are also evaluated to determine the scope for the present plan to cover remediation validation. Previous annual audits may have revealed that items originally deemed high risk are appropriately managed and risk is mitigated, requiring less than annual attention. Other processes that had been regarded as low risk may require evaluation more frequently because of no operational monitoring.

The audit plan also needs to incorporate annual regulatory compliance requirements facing the organization. Evaluating such factors and considerations lets the internal audit department develop a plan scope that directs sufficient attention to the current risks facing the organization.

### Determining Human Resources Needed for the Internal Audit Plan

**THE SCOPE OF THE INTERNAL AUDIT PLAN** provides a basis for determining the necessary skill set levels and estimating the amount of labor hours required for the annual audit.

Specific skill set needs vary from one organization or industry to another; however, internal audits generally require individuals with expertise in management planning and review, financial reporting, IT and operations, as well as specific industry expertise. The plan's scope helps the internal audit department establish skill set levels and priorities that meet the organization's needs.

Varying levels of experience and expertise among internal audit department staff also influence the total number of work hours required by the annual audit plan, as do the number of items included in the plan.

Consideration of those factors lets the internal audit department determine whether the department's present staff can execute the annual plan. If the plan's total required work hours exceed current available staff hours by over 1,500 man-hours for a particular staff level and skill, the department should consider hiring an additional staff member. If the amount of additional required labor is less than 1,500 man-hours or if the particular skill set needed does not merit hiring another staff member, the department may contract for necessary expertise with an outside service provider.

### Determining Timing for the Internal Audit

**THE INTERNAL AUDIT** customer's schedule influences the optimal timing for the internal audit and various aspects of that plan. Customers include senior management, the audit committee and board of directors, managers of various business units and auditee departments. The availability of the internal audit team, including outside service providers, also influences the scheduling for various evaluations. Compliance requirement deadlines and external auditor requests will also influence the timing of certain internal audits.

Aspects of the internal audit plan can be executed at different times throughout the year, with a goal of minimizing business disruption. A major consumer retailer, for example, may generate a disproportionately large share of its annual earnings between Thanksgiving and Christmas. Conducting operational audits during December could distract managers and staff members from focusing on meeting customer needs and maximizing sales revenue.

While minimizing business disruption, the internal audit plan also needs to address areas at times when vulnerabilities are most evident. In the retailer's case, that could mean conducting numerous assessments in January when awareness of difficulties encountered during the holiday peak sales period would still be quite high. Other elements of the plan could then be executed outside of their high traffic time, between January and Thanksgiving.

In addition, the internal audit plan should be designed with flexibility. The internal audit function is often called upon to consult on important operating initiatives, such as an implementation of a new operating system or the divestiture of a division. The internal audit plan will also need to accommodate the increase in scope of a particular audit based on findings during the audit or the addition of a new audit area based on an occurrence or concern of management.

### **Residual Benefits of Developing the Internal Audit Function**

**THE INTERNAL AUDIT PLAN** reflects the internal audit strategy, considers the annual risk assessment and builds upon the development of the internal audit function. Planning for an audit requires addressing resource and scheduling concerns for both the internal audit customer and the internal audit team. Such planning helps balance assessment needs against resource constraints and the potential for business disruption.

By planning the internal audits on the year's internal audit plan in advance, the department assures that areas identified in the internal audit universe receive the attention required by their risk ratings. Evaluations of past audits also help the internal audit team determine the appropriateness of previous risk ratings. That information lets the internal audit team plan and execute annual audits more efficiently and effectively. The annual audit plan also addresses any new risks that may have arisen since the previous year's audit.

The information gleaned from the internal audit department's monitoring and risk assessment efforts makes the audit committee and management aware of the risks facing the organization. Based on those assessments, the board of directors and management can determine whether identified risks align with the organization's risk appetite and that the residual risk is within the thresholds set. Using enterprise risk management methodology, the board and management can then choose the most appropriate responses to risks deemed unacceptable.

Such efforts help protect the organization from unrecognized risks. That continual monitoring of risks also provides assurance to employees, investors and other stakeholders, enabling them to place greater confidence and trust in the organization.

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- Enterprise risk management
- Internal audit
- Internal control evaluation
- Integrated financial and IT audit
- Performance audit and measurement
- Regulatory compliance
- Risk assessment
- Sarbanes-Oxley compliance

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