
Audit Frequency: How often to audit?

By John Frank, KnowledgeLeader contributing writer – www.knowledgeleader.com

Veteran auditors can recall when most American companies followed an auditing cycle based primarily on time. Units within a company were scheduled for audits every so many years and internal audit directors put together three- or five-year auditing plans that encompassed such cycles.

Those days, say many experts, are either gone or fading fast from the business scene. Change has become such a major presence in business today that it - along with world uncertainty that can impact business - is driving more and more internal audit departments to create audit cycles based on risk.

High-risk units within a company are being looked at annually. Factors that have an impact on risk - such as adding major new software to a company's technology infrastructure - are being considered when internal auditors are deciding what to audit when, the experts agree.

High-risk units can include IT security, newly acquired operations and ventures with a history of problems.

Individual industries have regulatory issues that may require annual audits of certain areas; HIPPA imposes such requirements in the healthcare arena, for example.

Audit committees, spurred by business upheaval and regulatory changes of the past few years, are asking more questions about audit cycles and becoming more involved in the process. Audit committees may be particularly interested in seeing annual audits of conflict-of-interest statements and senior management expense reports, given recent scandals and the regulatory changes that resulted.

Mark Salamasick, now director of the endorsed internal audit program at the University of Texas at Dallas, recalls that when he ran the information technology (IT) audit group for Bank of America, that financial giant had moved to risk-based auditing cycles as early as 1997 and 1998. Previously, the bank had used five- and three-year audit cycles, but that approach became outmoded as the pace of business change increased. Salamasick worked at B of A for 20 years until 2002 -- 18 of the 20 were in Internal Audit.

In today's world of mergers, acquisitions, spin-offs and business restructurings, "the units never look the same," notes Glenn Sumners, director of the Louisiana State University Center for Internal Auditing. "The greater the degree of change, the less people use a cycle approach," he says.

Looking for the signals

Factors that determine risk include a history of past auditing problems within a given unit, newness of a unit and changes in business or world conditions that can have an impact on risk within that operation. Unit performance can be another factor that prompts an audit, says Sumners. A location turning in an unprofitable performance may be flagging itself for an audit. "The longer you go without an audit, the greater the probability you will have performance drift," he says.

Acquisitions should be carefully scrutinized before a takeover is completed, Sumners and others agree. Examine how various units in the acquired operation were audited in the past and how they managed risk, says Tom Andreesen, director in the Kansas City office of Protiviti. Once acquired, a business unit "will probably be high on the radar screen because it's new," he explains. "The beauty of a risk-based solution is it's truly based on current events."

Factors to Consider in Determining Audit Frequency

Capability of location management

Degree of change

Employee and/or management turnover in a given location or operation

History of problems and issues
Indication of performance measures that suggest problems

Inherent risk in an operation or location

Old audit plans in place for an acquired business "would go out the window," says Salamasick. New audit plans should reflect the new structure a takeover brings to a company. "What you're going to have to do is look at the dynamics of the changing organization" to determine risks and audit frequency, he says.

Auditing overseas operations presents special challenges such as knowing local laws and regulations and understanding business culture of the region. Some feel the more distant an operation from headquarters, the greater the business risk and the more need to audit frequently. Others note that cost becomes an issue. Some multinationals address the cost issue by having audit groups in key locations around the globe to handle foreign operations, says Salamasick.

A matter of dollars and sense

The entire concept of risk-based auditing cycles can raise cost issues. How does an internal audit director allocate resources for a given year when risks can change with a sudden change in business or world conditions? Sumners advocates having a staffing reserve to cover unanticipated auditing needs. (See: [Staffing Today's Internal Audit Function](#).)

When new auditing projects arise, "it becomes a discussion, and it's not done in a vacuum," says Andreesen. "It tends to be an interactive discussion" that involves a company's audit director and audit committee.

Says Salamasick: "The role of the audit committee has changed to where they are

more attuned to where you are using your resources." He expects to see audit committees become more vocal about what business units should be audited when. "You're going to see them asking questions" about decisions on which units get audited, he says.

For some companies, auditing processes may be more cost-effective than looking at individual business units, he adds. Auditing a process entails looking at how it affects a company across unit silos and can find company risk that might not be apparent looking at one unit.

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