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***Correspondence Memorandum***

**Date:** February 11, 2019

**To:** Audit Committee Members

**From:** Yikchau Sze, Director  
 Office of Internal Audit (OIA)

**Subject:** Internal Audit Planning and Audit Frequency

**Staff recommends the Audit Committee (Committee) approve the audit frequency guidelines.**

Audit planning is a process that identifies auditable units of an organization, assesses risks of each auditable unit using an industry acceptable methodology, and determines which audits to perform, based on the risk tolerance of the organization and available resources. The audit plan is a critical document that ensures the internal audit resources are used efficiently and effectively to fulfill internal audit’s mission of enhancing and protecting the organization’s value through risk-based and objective assurance, advice and insight. The audit plan is also a valuable tool that provides information to the Committee for its oversight of the resources required for the appropriate audit coverage of the organization’s operations and processes.

Audit Planning Process – OIA Biennial Risk-Based Planning

Biennially, OIA develops an audit plan that drives much of the daily OIA activities for the next two fiscal years. The plan is created by using a systematic approach in identifying significant risks and prioritizing the risks based on severity of the risks; ETF operational needs; strategic directions; and available resources to OIA. The audit plan is a dynamic document, as it will be modified to respond to changes in ETF’s risk profile.

This planning process has been repeated and refined every two years since the 2015-2017 plan years, which was the start of this risk-based audit planning process. Examples of plan improvement included refinement of audit universe and risk assessment approach. Audit universe represents auditable units within an organization. OIA identified audit universe by ETF’s operational units at the division and office level in the first planning cycle five years ago. During the second planning cycle, audit universe was refined to align with major business functions, with risks being assessed at major sub-process levels of a major business function. This resulted in a more comprehensive analysis of risks.

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The methodology of risk assessment itself has also been improved and refined. Illustrating examples were provided along with risk rating criteria. The risk matrix was updated to reflex the refined risk rating criteria. Residual risks, the left-over risks after factoring in the strength of existing controls, were mapped automatically to the risk heatmap to indicate the type of service OIA would provide.

The sources of risk assessment are stakeholder input, including ETF and Committee members; prior internal and external audits results; regulatory and compliance requirements; and various other inputs.

### Audit Frequency – Institute of Internal Auditors (IIA) Quality Assessment Recommendation

Audit frequency is the number of audits carried out over a period time for a particular auditable unit. The higher the risk, the more frequent the audit. However, the cost of auditing a given audit unit many times during a planning horizon should be balanced against the cost of not auditing that unit. IIA standards do not define how often audits should be performed given a particular risk rating, nor does it require audit frequency be developed to support audit planning. However, it is a common practice for an internal audit function to have a frequency schedule for two reasons, which are somewhat related. One is to ensure audit provides adequate coverage for an organization, as a rotation system can be established behind a multi-year risk-based audit plan. Another reason is for internal audit to budget resources needed to provide such coverage.

However, as the IIA's own research<sup>1</sup> discovered that "rotational planning often means that every part of the organization should be audited at least once every (defined number) years...this rotation could lead the internal auditors to conduct audits on process that are very stable – time could have been allocated to riskier areas of the organization." As stated by an interviewee cited in the research paper, "We have an audit universe that is composed of 70 auditable units and our goal is to cover every high-risk auditable unit every three years and the other every five years...we lose time in order to respect our covert strategy." In addition, the research paper points out, that "the rotation system could make the plan less dynamic because the rotation implies that audit engagements occur after a defined period of time. As a result, the internal audit could come too soon or too late for an audit engagement."

One of the practical actions recommended by the paper is to "avoid the rotational risk-based plan to dedicate more time to riskier areas."

In the past five years, OIA has been focusing the audit efforts on the high- and moderate-risk areas and conducting consulting services to address risks deemed very

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<sup>1</sup> Internal Audit Foundation © 2018 *Aligning Internal Audit Activities and Scope to Organizational Strategy* by Nathanael Betti and Gerrit Sarens

high so that management can implement mitigating controls or develop strategy more quickly to reduce risks.

In May 2018 an external quality assessment conducted by the IIA identified a gap in OIA's conformance to the IIA standard *2020 Communication and Approval*. It concluded that "while the current OIA biennial planning process and format of the plan appropriately meet the requirements of *Standard 2010 Planning*, the data and information provided to senior management and the Committee needs to be strengthened to provide them with an adequate basis to assess, understand, and provide proper oversight of the resources required to provide the proper audit coverage of ETF operations and processes." Among other recommendations, which were implemented by the OIA, it recommends:

- Consult with senior management and the Committee in developing audit frequency guidelines, based on risk prioritization. The guidelines should be approved by the Committee.
- Prepare multi-year plans that reflect the audit frequency guidelines

OIA acknowledges the value audit frequency guidelines provide, as discussed above, as a tool to assess the audit coverage provided to business areas with different risk ratings, and as a tool for resource evaluation. To keep the audit plan dynamic and to avoid the pitfall of the rotation system, OIA will use the audit frequency as a reference when assessing the desired audit coverage and the resource requirement to achieve the coverage; not as a mandate to establish a rotating audit schedule to achieve full coverage of all the auditable units within ETF.

OIA will perform a five-year look back on audit coverage, to ensure the coverage is in line with the frequency guideline for the high and moderate risk rating areas, and to determine the appropriate coverage for the low risk areas. Any gaps identified from the look back exercises, based on the approved audit frequency guidelines, will be considered when developing a new biennial audit plan. For example, Employer Reporting, was last audited in 2016. If the risk is deemed high, the area should be included in the 2019 – 2021 biennial audit plan because it should be audited no less than every three years, according to the frequency guidance below. However, since a follow up audit to the 2016 audit was performed in 2018 with satisfactory results, and the OIA has extensively involved in the project of Employer Compliance Review in 2018, conducting a full scope audit of Employer Reporting in the new plan years may not be the best use of OIA resources. Whereas for Call Center, even if the risk is considered low, since it has never been audited before, it could be included in the new audit plan to ensure adequate coverage of ETF operations and processes, if the riskier areas are addressed by the audit plan.

OIA will report the five-year audit coverage analysis to the Committee to assist the Committee in overseeing the resources required to provide the proper audit coverage of ETF operations and processes.

OIA recommends the Committee establish the following guidelines:

<b>Risk Rating</b>	<b>Frequency</b>
High	< = 3 years
Moderate	4 – 5 years
Low	6 – 7 years
Very Low	N/A

Staff will be available at the Committee meeting to answer any questions.