

## **A STUDY CASE ON PLANNING ACTIVITIES DURING THE AUDIT ENGAGEMENT**

**BOGDAN RĂVAȘ \***

**ABSTRACT:** *Internal control is found in the composition of each activity within the City Hall and is formalized through procedures in conjunction with job descriptions and the Organization and Operation Regulation (ROF), which are accompanied by lists of activities and responsibilities attached to them in the form of practical implementation instructions of internal control.*

**KEY WORDS:** *audit, planning, ,efficient,mission.*

**JEL CLASSIFICATIONS:** *B 21, M 42.*

### **1. INTRODUCTION**

The research methodology of this paper is based on debates regarding the planning activity that involves determining the major areas of the audit.

As a result of this debates, planning of the internal audit activity is carried out on three levels:

- long-term strategic planning takes into account the activity of assessing the internal audit function of the subordinate structures that have organized audit compartments every five years according to the normative framework of the internal audit;
- medium-term strategic planning takes into account that, according to the law, all auditable activities must be audited at least every three years. Depending on the importance of an activity within the entity, the risk of occurrence of events or even damage, and the degree of occurrence and significance of the risk, it may be included in the audit;

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\* Lecturer, Ph.D., University of Petroșani, Romania, [ravasbogdan@yahoo.com](mailto:ravasbogdan@yahoo.com)

- annual planning includes missions to be carried out in the coming year taking into account the time available in the plan and the resources allocated annually. Each audit mission will include the objectives, the identification of adjacent activities, the hours worked, the staff and the hourly planning for the activities and departments of the public entity under examination.

## **2. THE INCIDENCE OF THE MOST SIGNIFICANT RISKS INVOLVED IN PLANNING THE AUDIT MISSION**

Incorrect or incomplete planning leads to the loss of risk-bearing activities. Practice requires carefully selecting activities in high risk audit areas on the basis of the risk analysis associated with these activities.

The risk typology and risk assessment criteria, respectively, must be effective and ensure that we have an overall view of the whole.

Major risks, as a rule, focus on the top of the organization, and it is therefore advisable to start planning activity from top to down. Starting from the bottom up, we find that some activities will be repeated several times. However, there is no guaranteed solution. The experience of internal auditors remains an important part of planning activity. It is important to plan our audits for major risks, and minor ones to lesser or less.

We believe that any planning we do should not forget the IT departments and public procurement that are generally risk-takers. It follows from practice that we need to decide whether we integrate IT activities and acquisitions in all audited areas or audit them separately.

Approaching process-based audit planning is good because it tells us what's going on from the beginning to the end of that process. It involves IT, human resources, financial accounting, acquisitions, sales, and therefore involves the use of longer time, so they are complex audits.

Internal audit standards recommend that we need to discuss with the management to achieve the planning. The public entity manager is responsible for internal audit planning and must approve the internal audit plan, but this does not mean that it can influence the removal of a domain or department contained in the plan.

Practitioners recommend that auditors also consult with people in organizations who have a global view of their activities, and they may be aware of risks that would otherwise escape, given that they are down, on the ground, involved, and we and even managers are more at work.

Once the risks are established, they are hierarchized on the needs of the tasks, and for this it is based on the objectives of the entity, the targets to be achieved.

If the volume of auditable activities for a year is very large, we are looking to see how much we can keep in mind for that year's audit, given the information we need and how we can get it. In this case, we need to establish a new list of auditable activities based on the available information and the best indicators per business field.

When planning auditable activities next year, we must prioritize high added value activities, the results of which will be relevant to those audited, as this creates a favorable impact on internal auditors.

Annual internal audit plans need to be adapted during the year whenever the entity's risk geography changes, and must also have a reserve for special or unforeseen events and time to provide management advice.

A good internal audit plan is that plan that has been tested in critical situations when a crisis occurs because in normal situations everything is doing well. For example, we are in the last day of planning and approval of the plan, and the draft internal audit plan is not ready and the head of the internal audit or the internal audit structure is missing from the entity and the natural question is: Is there a procedure for such situations, or do we have to talk to people and see what's going on? Obviously a procedure will also be developed for this particular situation.

In planning, everything that we forget can not be captured and remains for a further period, within the three years set by law.

The planning of the internal audit activity should also take into account the professional training days of the statutory audit, as well as the days of rest leave. Then, beyond the mandatory targets, the auditors' time budget and the financial budget for the planned activities are established.

An audit plan is well appreciated when 70% of the time budget is affected for internal audit work. The method of budgeting is that for each goal we calculate what we need and then sum up and related services to determine our value.

Reporting should be based on established goals, modalities, and expected results. According to I.I.A. - The Institute of Internal Auditors, Head of Internal Audit, must undertake risk-based planning to prioritize the organization's objectives.

The program of internal audit missions should in turn be based on a risk assessment carried out at least once a year and take into account the point of view of general management.

In situations where we have proposals also for a counseling mission, the head of the internal audit structure, before accepting it, needs to consider to what extent it can add value and contribute to improving risk management in the organization's operations. The counseling missions that have been accepted must be integrated into the annual internal audit plan, which will then be submitted to the general manager for approval.

### **3. THE INTERNATIONAL PRACTICE AND THE INTERNAL APPROACH**

The objective of the risk model is to optimize the allocation of audit resources through a comprehensive understanding of the universe of the audit scope and the risks associated with each element of the audit.

Good international practices adopted by IAA, starting with the development of the Audit Plan, recommend a risk audit model to quantify the level of risk of each audit unit in order to schedule audits according to established priorities.

This is a separation from past practices that were less based on formal risk judgment, and more so over the time elapsed since the last audit.

A risk analysis model recommended by IAA is based on 6 risk factors, namely:

- previous audit findings;
- sensitivity of the system, as perceived;
- control environment;
- trust in operational management;
- changes in people or systems;
- complexity.

Each element in the audit universe will be quantified using these 6 factors using a numeric scale from 1 to 3 where:

- 1 means "probably no problems";
- 2 means "possibly a problem";
- 3 means "probably a problem."

The results of these analyzes are totalized and then multiplied by an "age factor" of the audit, such as:

- 100% if a similar audit has been done over the last 24 months;
- 125% if the audit was done 25-36 months ago;
- 150% if the audit was done 37/60 months ago;
- 200% if the audit is older than 60 months.

The levels of the results will be spread over a range of 6-36, which after the completion of this scoring process will be grouped into 4 categories, depending on the risk factor presented, as follows:

- the top 10% layer represents the maximum risk level;
- the 30% layer represents the level of sensitive risk;
- the 40% layer represents the moderate risk level;
- the last layer of 20% is the low risk level.

The framework for the annual internal audit plan is then constructed from 4-layer samples using the following coverage targets:

- high-risk audit entities will be audited at a rate of 100%;
- the sensitive risk layer will be audited at a rate of 50%;
- 25% sample will be audited from the moderate risk layer;
- the low risk layer will be audited by selecting 10% elements.

Lower risk groups are sampled to see if the scoring process works and confirms that the risk levels are properly classified.

While the risk model still requires judgments, individual levels are documented and can be critically and polemically analyzed.

The model also promotes the uniform definition of the audit universe of each segment. Thus, the audit risks at each location of the public entity can be compared to those of the other locations on an objective basis. This will guide the use and geographical distribution of staff.

Defining the audit universe is the first prerequisite for risk hierarchy. This determination of the scope of the audit will be based on the knowledge of the organization's strategic plan and activities and the discussions with the human resources department.

The general rules for the application of the public internal audit contain a common methodology for risk assessment both for the procedure of drawing up the Public Internal Audit Plan and for conducting an audit mission during the preparation of the Audit Program and involves the following steps:

- a) Identification of auditable activities;
- b) Identification of inherent risks associated with activities;
- c) Establishment of risk analysis factors and their levels of appreciation;
- d) Establishing the level of risk on the criteria of appreciation;
- e) Determining total risk score;
- f) Classification of activities based on risk analysis;
- g) The hierarchy of activities to be audited;
- h) To elaborate the detailed thematic of auditable activities;
- i) Elaboration of the annual internal audit plan.

The identification of auditable activities is based on the analysis of the establishment act, the organizational chart, the ROF, the decisions for organizing new activities and so on.

Risk assessment needs to address change management: people change, methods change, organizations and policies change and as such and risks change.

Risk assessment means identifying and analyzing relevant risks in meeting the objectives to know how they are to be managed.

Risk assessment is part of the operational process and must identify and assess internal and external factors that could negatively affect the organization's objectives.

Internal and external factors need to be considered in a risk assessment approach.

Internal factors are, for example, the nature of the entity's activities, staff qualifications, major organizational changes, or employee performance. External factors may be the variation in economic conditions, changing the legal framework, the political factor or the changes in technology.

The identification of risks associated with activities must take into account the internal control forms and the existence and functionality of the procedures. Knowing that for any activity a working procedure is developed that will also contain internal controls, if it is missing, the activity poses potentially greater risks than those for which procedures are being developed.

It is based on the fact that the execution staff, without a unitary procedure, will understand very hard the activity and, implicitly, its realization in practice.

The establishment of the risk analysis factors and the levels of their assessment are made taking into account the recommendations of the General Norms for the use of the factors regarding the assessment of the internal control, the quantitative assessment and the qualitative assessment, to which we can add other factors specific to the activity.

For example, we propose for the financial accounting field to use the factors: legislative changes and the age of the staff.

It is worth mentioning that the weight and risk of the risk factor are taken into account in determining the risk weight and that the sum of the risk weights should be 100.

Depending on the chosen criteria we determine the following weights:

- assessment of internal control 40%;
- 25% quantitative assessment;
- quality assessment 20%;
- legislative changes 10%;
- age of staff 5%.

The risk factor is the element used to identify the likelihood that events have a negative impact on an auditable activity.

The level of the risk assessment factor is the change caused by the impact of the risk on the auditable field.

The determination of the level of risk on the criteria of appreciation is achieved by applying to each factor of risk analysis a level of appreciation.

Determining the total risk score is done by applying the weighting of each risk level to risk levels in order to determine the total score based on the formula:

$$TS = \sum IW * IL$$

where:

TS - total score;

IW - risk weight for each factor;

IL - the level of risk for each factor used.

The ranking of activities based on the risk analysis is based on the total scores obtained previously, determined in order of impact on the auditable domain, and is separated on a three-tier scale: large, medium and small.

The hierarchy of activities to be audited is based on the previous situation, taking into account also the number of staff, the available time, other activities carried out within the internal audit structure and, in particular, the risk analysis identified in the other areas of the entity.

The themes of detail are based on the strengths and weaknesses situation, drawn up in the previous stage, and include the internal audit missions that will be part of the plan for the future.

For the preparation of the Annual Internal Audit Plan it is necessary to determine for each objective the audited period, the time necessary for the accomplishment of the missions and the number of auditors involved.

The audit plan drawn up by the internal audit department on the basis of risk analysis is subject to the approval of the entity's management. Subsequently, as required, it can be updated, but also based on risk analysis and with the approval of the entity's management.

#### **4. CONCLUSION**

The audit mission is an integral part of the Internal Audit Plan, which analyzes the details of the audit scope, the objectives, the activities to be assessed to identify the associated risks, the audit period, the time to identify the associated risks, mission accomplishment and number of auditors.

Previous audit findings - are an indicator of internal control discipline. Problems are often characterized by significant control deficiencies, significant changes (adjustments), a number of findings higher than normal, and repetitive findings are not fixed. On the contrary, the lack of findings and the regular correction of previous findings indicate a discipline of control.

Sensitivity is the assessment of the inherent risks associated with the rated entities. This is an assessment of what potentially could lead to irregularities in the future and which will be the associated reaction that can be linked from the point of view of risk to loss or decomposition of assets with undeclared errors with unrecognized or unquantifiable debts, or adverse advertising risk, legal obligations, etc. Quantification of sensitivity should also take into account the size of the entity under consideration, potential exposure and probability.

The control environment is the collective policies, the procedures, the usual rules, the physical protection measures of the patrimony and the personnel used for this purpose. Essential for a favorable control environment is peak tune, adherence to policies and procedures contained in documents, secure systems, prompt detection and correction of errors, adequate staffing, and a number of staff kept under control.

On the contrary, lack of supervision, high error rates, lack of documentation, large amounts of unmanaged work, poorly managed, large numbers of staff and unregulated operations are symptoms of a poor control environment.

Comfort is characterized by factors such as: collaboration in previous audits, management experience in the work environment, and perceptions of quality and staffing.

Practice indicates that changes have an impact on internal controls and financial reporting. Changes usually occur to have long-term effect, but often short-term changes require more attention from the audit.

Changes include reorganizations, changes in business cycles, rapid growth, new product lines, new systems, acquisitions and sales of parts of the firm (capital), new regulations or laws, and fluctuation of staff. Audit units less affected by changes will be less audited.

Complex risk factors are the potential for committing errors or inaccuracies that could go unnoticed (undetected) due to the complexity of the environment. Quantification and complexity will depend on several factors.

Extending automation, complex calculations, interdependent activities, large numbers of products or services, time horizon of estimates, third party dependence, customer requests, processing times, applicable laws and regulations and many other factors, some of them unknown, influence judgments about the complexity of an audit.

Improving the risk quantification model must remain a permanent priority of the internal audit function.

The objectives of internal auditors are to allocate audit resources in an optimal manner, to the highest risk audits, to heal the entity's activities / sub-activities, and resource saving based on the fact that risk analysis remains a priority.

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