

Caribbean Association of Audit Committee Members Inc.

Communications: The Backbone of
the Relationship with the Internal and
External Auditors
July 2009

Agenda

- Internal Audit
- External Audit

Internal Audit

Determining Scope

- Risk Assessment
 - Risks considered
 - Risk rating methodology
 - Macroeconomic and competitive environment (external factors)
 - Business review (internal factors)
 - Priority business objectives
 - Potentially significant risks
 - Related controls
 - Test plan (timing and scope)

Audit Plan

- Scope
 - Risk assessment document
- Methodology
 - Planning
 - Annual work plan
 - Individual reviews
 - Execution
 - Reporting
 - Quality Assurance
- IA Charter

Reporting

- Quarterly reporting cycle
- Format
 - Executive Summary
 - Findings, conclusions and overall review rating
 - Classify by type: high, significant, moderate, low
 - Impact
 - Key issues and agreed actions
 - Responsibilities
 - Target completion dates

Reporting

- Detailed findings and conclusions (high, significant, moderate rates items only)
 - Issue, cause, impact, recommendation
- Management response
 - Action plan, responsibility, target completion dates
- Status of matters previously reported
 - Internal audit cycle
 - Other
 - External audit
 - Other reviews

External Audit

Audit plans and audit strategy memoranda

- Terms of reference/objectives/expectations
- Communications plan
- Audit approach and scope
- Risks and responses
- Fraud risk
- Materiality and unadjusted differences
- Effectiveness of the external audit process
- Presentation of hour/fee information
- Partner rotation, if applicable

Terms of reference/objectives

- Primary objective
 - To express an opinion on financial statements
- Other responsibilities
 - As defined by legal and regulatory requirements, specific requests from entity
 - May be multi-faceted
 - Shareholders
 - Audit committee
 - Management
 - Regulators

Expectations

- Deliver a smooth, thorough and efficient audit by:
 - Discussing the approach and areas of focus in advance
 - Avoiding surprises through timely reporting of issues
 - Ensuring clarity of roles and responsibilities
 - Meeting deadlines
 - Providing continuity and succession planning for key staff
 - Providing sufficient lead time for adequate consideration of, and response to, draft reports

Expectations

- Adherence to independence standards
- Provide up to date knowledge on technical issues
- Provide accurate and timely advice
- Consistent advice at all levels
- Serve as a source of industry knowledge, communicating best practice and industry trends in reporting
- Deliver a focussed and consistent audit approach
- Liaise with internal audit to avoid duplication of effort

Communications plan

- Must address timing and scope, provide for formal and informal approaches
- Linked to audit cycle
 - Half year review
 - Analytical review of half-year results
 - Review of judgement areas
 - Follow up of previous year end and new issues
 - Discussion of new accounting standards

Communications plan

- Mobilisation and planning
 - Agreed audit objectives, strategy and plan
 - Fee proposal
- Implementation
 - Interim internal control report
- Pre year end issues
 - Key accounting and audit issues discussed and resolved
 - Agreed format and presentation of financial statement report

Communications plan

- Year end audit completion
 - Report on audit results and findings
 - Final internal control report
 - Statutory audit opinion
 - Regulatory opinions
 - ISA 260 report
- Continuous communication
 - Regular contact with executive and business unit management
 - Discussion of, and response to, issues as and when they arise

Audit approach and scope

- Based on understanding of business
- Risk assessment forms basis of planning and guiding subsequent testing
- Reliance on control environment
 - Process
 - Risks
 - Management controls
 - Evaluate controls effectiveness
 - Test
 - Assess

Risks and response

- Based on 'top-down' risk assessment
- Considers:
 - Knowledge of entity
 - Reliance on control environment; work of internal audit
 - Effective operations of management controls
 - Level of manual processes or management judgement
 - Financial incentives or pressures for reporting earnings
 - Materiality of individual balances
 - Inherent fraud risk
 - Changes and complexity

Risks and response

- Links:
 - Key business units, functions, issues leading to audit risks, too...
 - Understanding of risks, to...
 - Audit response

Fraud risk

- Specific requirement under ISA 240
- Not external auditors' responsibility to detect fraud, but audit procedures must seek to identify material misstatement resulting from fraud
- Assessment considers three underlying factors:
 - Incentive/pressure
 - Opportunity
 - Rationalization/attitude

Materiality and unadjusted differences

- Overall materiality
 - Nature, timing, and extent of risk assessment
 - Identifying and assessing risk of misstatement
 - Nature, timing and extent of other audit procedures
- Planning materiality
 - Identify significant accounts; basis for analytical review or substantive testing
- ‘De minimis’ threshold
 - No adjustment
- Requirement to report material adjusted and unadjusted errors

Effectiveness of external audit process

- Formally obtain and respond to feedback from audit committee
- Part of evaluation process, separate audit effectiveness evaluation

Presentation of hour/fee information

- Drivers:
 - Size and complexity of operations
 - Ability to rely on control environment
 - Reliance on internal audit
- Analysis of level of effort by:
 - Business unit
 - Reporting function
 - Grades of staff

Reporting audit results and findings

- Overview of results
- Audit and accounting issues
- Reporting on controls
- Reporting results of Technology Assurance projects

Overview of results

- Discussion of overall results for reporting period
- Presentation and disclosure
- Variances, from budget and prior year

Audit and accounting issues

- Significant accounting policies, particularly in relation to significant unusual transactions, policies in controversial or emerging areas not covered by authoritative guidance
- Critical accounting policies and practices
- Alternative treatments
- Quality of policies
- Management's accounting estimates
- Audit adjustments
- Impact of significant risks and exposures
- Material uncertainties related to events and conditions

Audit and accounting issues

- Other information in documents containing audited financial statements
- Disagreements with management
- Difficulties encountered in performing audit work
- Major issues discussed with management prior to retention
- Significant deficiencies in internal control
- Fraud and illegal acts
- Independence
- Fees
- Other communications

Reporting on controls

- Overall positioning on the control continuum
- Potential drivers for change
 - Expectations of customers, suppliers, shareholders and other stakeholders
 - Initiatives to adopt 'best practice'
 - Competition
 - Process improvement
 - Streamlining and standardisation
 - Reducing cost of compliance

Reporting on controls

- Potential triggers for change
 - Known control deficiencies
 - Complexity
 - New systems or processes, shared services or outsourcing
 - Expanding or emerging markets
 - Significant growth or change
 - Risk management processes
 - Lack of ownership and awareness of risks and controls

Reporting on controls

- Benefits
 - Managing cost of compliance
 - Efficiency/process improvement

Reporting results of Technology Assurance projects

- Report on work performed in relation to controls over management's IT processes supporting key financial application systems
- Determine level of reliance on integrity of accounting information derived from IT processes
- Scope
 - IT governance
 - Emerging technology
 - IT assets
 - Data quality

Reporting results of Technology Assurance projects

- Sourcing risk
- Projects
- Global IT
- Business resilience
- Business systems
- Security and privacy
- Compliance with regulation

Current topical issues

- Changes to the regulatory and reporting landscape
- Reporting on corporate governance statement
- The Companies Act or other applicable legal standards
- Audit regulatory environment
- International Standards on Auditing
- Audit quality
- The business review

Current topical issues

- Critical accounting policies/alternative accounting treatments
- Presentation and disclosure
- IRFS accounting developments
- Tax hot topics
- Pensions hot topics
- Other matters

Reporting on corporate governance statement

- No existing guidelines
- Best practice involves specific disclosures relative to:
 - Directors responsibilities for preparing accounts and reporting
 - Review of effectiveness of internal controls
 - Establishment and composition of audit committee
 - Written charter defining role and responsibility of audit committee
 - Work of audit committee in discharging these responsibilities

Reporting on corporate governance statement

- Establishment of whistle-blower arrangements
- Oversight of internal audit activities
- Responsibility for making recommendation on appointment, re-appointment and removal of external auditors
- Safeguards for external auditor independence and objectivity

Audit quality

- Client acceptance and retention
- Audit methodology
- Special reviews
- Scope of services
- Quality reviews
- Partner rotation
- Technical consultation
- Personal independence
- Training and development

The business review

- Description of business environment in which the entity operates
- Clear description of company strategy
- Key performance indicators
- Identification of principal risks and uncertainties

Questions?