

NBAA SEMINAR ON AUDITING AND UPDATES ON THE IAASB PRONOUNCEMENTS

*Thursday 12th and Friday 13th May, 2016, AT APC Conference Hall and
HOTEL – Bunju Dar-es-salaam*

Performing Effective Audit &
Protecting Audit Results from
Disclosure

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About the Resource Person

- Joseph is a ACPA-PP currently heading Ernst & Young
- Has over 16 years of experience in audit and consultancy services ranging from CAG, PwC and finally EY UK and Tanzania
- He is a lifelong learner - holds 3 Masters i.e. MBA (Oxford University) UK; MSc. Audit & Consultancy (Birmingham City University), UK; MSc. Forensic Accounting (Portsmouth University) UK
- Presently, Phd candidate in Auditing (Birmingham, UK)

Effective or Ineffective Audit????



“You handled the audit so well, we’re promoting you from Accounts Receivable to Accounts Deceivable.”



It went pretty Well, The Auditor took one look at my Files and Retired!

Effective or Ineffective Audit????



“The word ‘audit’ comes from ‘auditory’ which means ‘to hear bad news coming’.”



“These numbers don’t look too pretty. Any way you can run them through Photoshop?”

Objective

- What is an Effective Audit?
- How to Achieve an Affective Audit?
- How can the Auditee Evaluate Audit Effectiveness?
- Myths and Facts about Audit Effectiveness
- How to Achieving Confidentiality in the Audit Process and thus Audit Results?
- External & Internal Audit Perspectives

Where does this come from?

- Shareholders
- Corporate Governance Principles & Rules Globally
e.g. UK Combined Code: Role of Audit Committee
- Public Oversight Bodies
- Parliament
- Supreme Audit Institutions - NAO
- Regulatory Bodies; BOT, TIRA, SSRA, BOT
- Professional Bodies – NBAA, IFAC, IODs

But what is an Effective Audit?

Perhaps?

- Audit objectives are achieved, efficiently? timely?
- What are these objectives?
- From whose perspective? Auditor or Client?
- Constructive recommendations were made?
- Too many errors/adjustments were noted?
- Shallowness or bulkiness of Management Letter?
- Qualification in accounts
- Nice, soft and praising Management Letter
- Too or less involving audit,
- Misstatements known to personnel not picked by auditor
- Ku-somesha watu namba?

But what is an Effective Audit?

- Means different things to different people.
- Beauty is in the eyes of the beholder?
- Formal definitions revolve around:
 - Quality assurance,
 - Skills & Competence,
 - Procedures/methodology; and
 - Independence of the auditor

But what is an Effective Audit?

- In practice, which is easier to identify?

But what is an Effective Audit?

- The output of an audit is in the form of a series of reports and presentations.
- Perhaps to some extent, the effectiveness of the audit is judged on these, and on the level of service given by the audit firm?
- What about quality of soft skills?
- What other professional literature say?
- Does timeliness of evaluation matter - change?

Formal definition

- Effectiveness can be regarded as a composite of competence, procedural arrangements, quality control and quality assurance. The procedural arrangements can be regarded as the tools used by firms and individuals to ensure that audits comply with technical standards, i.e. legal requirements, regulators' requirements and auditing standards set by regulators, and taking into account the supplementary material in Practice Notes and Bulletins. (ICAEW)

Audit partner point of view

- *“Do I understand the risks in this business? Has the audit dealt with them? Do I understand all the compliance issues? Is it covered in my internal review? Have I understood all of the audit committee’s concerns and expectations? Have I looked at the committee as a whole and at the individual members, as their issues may be different? I have to deliver to standards, but have I understood it from the other side as well as complying with company law?”*

Dilemma

- It is easy to see, with hindsight, what was not effective, but effectiveness itself is less obvious.
- If you know what is not an effective audit you can see what is.
- If something goes wrong you know it's not effective ... but if there was no underlying wrong, you might never know the audit was not effective."

Dilemma

- The matrix below shows 4 possible alternatives, only one of which will present problems.

Audit effectiveness in the presence or absence of underlying problems

Yes	<p>(1) If the problem is later uncovered, this is evidence, in hindsight, that the audit was not effective.</p>	<p>(4) The audit detects the problem – effectiveness demonstrated.</p>
Was there an underlying problem?	<p>(2) No direct evidence to demonstrate that the audit was not effective.</p>	<p>(3) No direct evidence to demonstrate that the audit was effective</p>
No	No	Yes
	Was the audit effective?	

Audit effectiveness in the presence or absence of underlying problems

- Quadrant 1 of Figure 1 highlights the danger to companies, auditors and Board. Here, a poor audit fails to pick up an underlying problem, potentially with serious consequences for all. Quadrants 2 and 3 present no danger to the Board – after all, there is no underlying difficulty. However, it is difficult for the Board to determine from direct evidence whether or not the audit was satisfactory: has it uncovered no problems because there were none, or because it was inadequately planned or conducted? Only in Quadrant 4 can the Board see direct evidence of the effectiveness of the audit.

Effective audit firm or audit? Is there a difference?

- There are two aspects to the effective audit – an effective audit firm, and the particular audit being effective.
- It would be possible for an effective firm to conduct an ineffective audit, due to a failure of procedures in that particular instance.
- Hence evaluation of audit effectiveness is still appropriate, regardless of regulatory activity aimed at ensuring the effectiveness of audit firms.

Determining effectiveness through examining characteristics of an effective audit team

- Is the team competent?
- Do its members have knowledge of the industry?
- Do they have sound judgment?
- Are they objective?
- Do they demonstrate integrity?

All of these matters are considered important.

characteristics of an effective audit

- The Finstat. presented a true and fair view
- Constructive recommendations highlighted
- Timely with minimal disruption to the company (methodology)
- Comprehensive risk based audit scope
- IFRS compliant Finstat.

Effective audit, but an Ineffective audit service?

- Yes, it is possible
- This would reflect problems in how the audit was conducted, rather than in the audit outcomes.
- It could be evidenced in personality problems between the audit personnel and the company's personnel or management
- Overall, the level of service is considered to be an important aspect of the whole process.

Effective Audit Firm

- “In a beauty contest, you assume the people in front of you are all qualified to do the task.”
- To deliver an effective audit, a firm must have established, resourced & implemented sound systems and procedures firm-wide and on each individual audits for ensuring highest quality audit work
- Whereas the firm may have best people, it may have no capacity or lack resources or industry skills

Effective Audit Firm

- The firm/Partners may lack independence
- Partner rotation also consider need for manager rotation
- Good to have a fresh pair of eyes on an audit
- Although 1st year learning curve can mean audit is less effective

The effectiveness-efficiency trade-off

- The effective audit is not necessarily an efficient one; nor does efficiency imply effectiveness.
- It would be possible for the firm to over-audit, conducting an audit that met all of the effectiveness criteria, but at the expense of too much management time & cost.
- Such inefficiency would not be satisfactory.
- Likewise, it would be possible for the audit to be conducted efficiently, but to be lacking in some areas and thus not effective.

The effectiveness-efficiency trade-off

- although unsatisfactory, an ineffective audit actually only causes problem if it fails to unearth problems that would otherwise have surfaced. At this point, it becomes dangerous for both the client and the audit firm.

The effectiveness-efficiency trade-off

- 2 views on the effectiveness/efficiency trade-off:
- (1) Audit firm may be ok to sign-off having examined, say, 75% of the company's activities, but that the Board might demand more assurance, for their own benefit.
- (2) Other the other hand, Auditors may over-audit aiming to protect their own position.

Evaluation of Audit Effectiveness

How?

- Audit by its nature is difficult to evaluate
- *“It’s hard to know in real time if it was an effective audit. You only know historically if it was not. ... Therefore, all you can do is judge: are they showing the characteristics of an effective audit?” Board*
- Looking at “intangible” matter of judgment

Evaluation of Audit Effectiveness Checklist/Questionnaire

- Novel idea – seed errors and see?
- Should be done informally by auditee?
- Generally agreed to use questionnaire method
- Checklist developed by Professional Boards such as IoD, firms themselves, IIA and Public Oversight Boards
- Adv: Completeness & audit trail
- Issues: who should complete? Self, Board, IA, Finance, CAG, both, Informal? – possible conflict?

Evaluation of Audit Effectiveness

4 Common Criteria

(1). Audit Planning & Design

- Team structure & leadership demonstrated by the audit partner
- Integrated audit approach
- Audit tailored to the business
- Leveraging sources of assurance
- Use of innovation & technology

Evaluation of Audit Effectiveness

4 Common Criteria

(2) Audit execution

- Behavioral factors including professional skepticism
- Technical excellence
- Communication and audit reporting
- Audit efficiency and project management

Evaluation of Audit Effectiveness

4 Common Criteria

(3). Firm-wide policies and procedures

- Independence and quality control
- Continuous improvement

(4). The role of management

- Management role in support of the audit process

Evaluation of Audit Effectiveness

Internal Audit Perspective

7 Attributes of Highly Effective Internal Auditors

(R. Chambers)



Evaluation of Audit Effectiveness

Internal Audit Perspective

- Natural inquisitiveness;
- Persuasiveness;
- Change management proficiency;
- A service orientation;
- An ability to recognize and respond to diverse thinking styles, learning styles and cultural qualities; and
- A global mindset.

Confidentiality in Audit Process



Confidentiality in Audit Process

- IFAC NBAA Code of Ethics, Labour Act, National Defence Act, 1966, National Security Act, 1970, Official Secrets Ordinances (Amendment) Act, 1963, The National Audit Act, 2008; Public Service Code

Confidentiality in Audit Process

- IFAC rules, Labour Act, National Defence Act, 1966, National Security Act, 1970, Official Secrets Ordinances (Amendment) Act, 1963 Parliamentary, The National Audit Act, 2008
- Confidentiality Risk Assessment

Confidentiality in Audit Process

Practical aspects

- Should all Accounts staff know company profitability, debtors, creditors etc?
- Should all auditors at an audit firm gain access to all audit files?
- Can auditors at a firm discuss audit issues noted at a particular client with colleagues internally?
- Can auditor discuss audit issues with spouse?
- By the way where are audit files kept at the firm?

Confidentiality in Audit Process

Practical aspects

- Should Management Letter be shared with all Senior Management team? Or should the CA hide it? Or should share only matters relevant to that department?
- Should auditors be allowed to speak to anyone in our organisation or we gag them?
- Can we control flow of information
- Can an audit team at a particular client share information while at the field?

Confidentiality in Audit Process

Practical aspects

- Report shared with Board members? Can they share it with their spouses? At their offices?
- CFO, leaves audit report with drivers, messengers, secretaries, can it be leaked?
- IT aspect, is our server secured?
- Is it confidential anyway?

Confidentiality in Audit Process

Solution

- Confidentiality at Firm Level
- Confidentiality at Client Level
- Confidentiality in Audit Team Level
- Effective Audit planning
- Establishing Rule of engagements
- Use of Tools
- Forensic technique – chain of custody, coding
- Declaration
- Remedial

- Thank you