

Assessing external audit effectiveness

Audit Committee Questions
Audit Committee Institute

The evaluation of external audit effectiveness is subject to increased regulator and investor focus. Not only is it core to the audit committee role – the committee must be satisfied that the audit is effective – but it can have an impact on any recommendations around audit tendering and/or rotation.

Ensuring a high quality audit

Transparency audit committee activities

Relationships with the auditor

Appointment of the auditor

Audit objectivity and independence

Audit committee oversight essentials ...

The audit committee has responsibility for managing the relationship with the auditor and ensuring that the auditor is directly accountable to the audit committee. The audit committee should maintain a strong and candid relationship with the auditor – otherwise this will limit the oversight the audit committee has of the external audit process – and should review the relationship between the auditor and executive management to ensure that an appropriate balance exists.

The competence and qualifications of the auditor should also be addressed. Some considerations to this effect include the:

- Auditor's understanding of the risks facing the company and their response to these in their audit plan.
- Performance and delivery against the audit plan.
- Robustness and perceptiveness of the auditor in handling the key accounting and audit judgements identified.
- How the auditor responds to questions from the audit committee.
- Comments provided by the auditor on the systems of internal control.

The evaluation should also assess the auditor's independence, objectivity and professional scepticism. This part of the evaluation might include consideration of:

- The level of challenge provided by the auditor as observed through conversations with and reporting to the audit committee.
- Safeguards to independence implemented by the auditor.

- Information provided to the audit committee on this area.

By the time any disputed issues are alerted to the audit committee, these may have already been resolved between executive management and the auditor, therefore it may be difficult for the audit committee to observe this challenge. This is something that the audit committee should consider and question. The most effective way to understand this may be through holding private meetings with the auditor. The audit committee should also keep in mind the degree to which the relationship with executive management and the committee itself may affect the objectivity of the auditor.

Evaluation of the external auditor on an annual basis is considered best practice. The process not only helps to optimise the performance of the auditor, it also encourages good communication between the auditor and the audit committee.

A questionnaire is often considered a good way of performing the evaluation, and this can also provide opportunities to track progress and improvements from prior years. However, it is also good practice to deploy other mechanisms and to ensure all relevant views are considered.

Evaluations of external auditors is an area that is subject to increased attention from regulators and investors. Audit committees may want to consider the level of transparency they provide in regards to the evaluation process: how it is performed; who it includes; what areas of performance it covers; the results and any actions.

Key questions for audit committees to consider:

Evaluation approach

- Have the following mechanisms for evaluating the effectiveness of the audit been considered:
 - Review of audit presentations and communications
 - Review of risk identification and delivery against the audit plan / tender document.
 - Assessment of professional skepticism throughout the audit.
 - Review of quality of staff, resources, geographic footprint etc.
 - Reviewing of the auditor's internal quality control procedures and reports?
- Are the results of the evaluation process discussed with the external auditor and any areas for improvement agreed upon?

Judgments and estimates: process and assumptions

- Did the audit team have the necessary knowledge and skills to meet the company's audit requirements? How did the auditor respond to feedback? Was the lead engagement partner accessible to the audit committee and company management?
- Does the audit firm have the necessary industry experience, specialized expertise in the company's critical accounting policies, and geographical reach required to continue to serve the company?
- Did the audit engagement team have sufficient access to specialized expertise during the audit?

Independence and professional scepticism

- Did the audit firm report to the audit committee all matters that might reasonably be thought to bear on the firm's independence? Did the audit firm discuss safeguards in place to detect independence issues?
- Were there any significant differences in views between management and the auditor? If so, did the auditor present a clear point of view on accounting issues where management's initial perspective differed?
- If the auditor is placing reliance on management and internal audit testing, did the audit committee agree with the extent of such reliance?

Quality of service provided

- Did the lead engagement partner discuss the audit plan and how it addressed company/industry-specific areas of audit risk (including fraud risk) with the audit committee?
- In multi-location audits, did the lead engagement partner provide information about the technical skills, experience and professional objectivity of other audit teams?
- Did the auditor meet the agreed upon and audit plan and objective performance criteria? Did the auditor adjust the audit plan to respond to changing risks and circumstances?
- Did the lead engagement partner advise the audit committee of the results of consultations with the firm's professional practice office?
- If the company's audit was subject to inspection by regulators, did the auditor advise the audit committee of the inspection findings and their impact on the audit results?
- Was the cost of the audit reasonable and sufficient for the size, complexity and risks of the company? Were the reasons for any changes to cost (e.g., change in scope of work) communicated to the audit committee?

Communication and interaction

- Did the audit engagement partner maintain a professional and open dialogue with the audit committee chair? Were discussions frank and complete?
- Did the auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments? Did the auditor discuss how the company's accounting policies compare with industry trends and leading practices?
- In executive sessions, did the auditor discuss sensitive issues candidly and professionally – including his/her views and concerns about reporting processes, internal controls (e.g., internal whistle blower policy) and the quality of the finance function?
- Did the auditor ensure that the audit committee was informed of current developments in accounting principles and auditing standards and the potential impact on the audit?

www.kpmg.com/globalaci