

# Annual Assessment of the External Auditor

## TOOL FOR AUDIT COMMITTEES

January 2014, updated September 2018



**CPA**

CHARTERED  
PROFESSIONAL  
ACCOUNTANTS  
CANADA



CANADIAN PUBLIC ACCOUNTABILITY BOARD  
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES



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# Commentary on 2018 Updates

While originally issued in January 2014, this publication has been updated in September 2018 to include commentary on audit quality indicators (AQIs). These changes have been prepared jointly by the Chartered Professional Accountants of Canada (CPA Canada), the Canadian Public Accountability Board (CPAB), the Institute of Corporate Directors (ICD), and a specially formed AQIs advisory committee.

The other content remains unchanged. Updates from original content are highlighted with a light blue flag in the margin.

## **Audit Quality Indicators**

### **Background**

AQIs have been gaining traction among audit committees and management as a way to quantitatively measure various aspects of the external audit. In this regard, AQIs can provide useful information for purposes of external auditor oversight and assessment by the audit committee.

Even though AQIs are primarily quantitative in nature, they are most useful when supplemented by contextual information and open dialogue among audit committees, management and the external auditor. However, because certain factors such as professional skepticism cannot be easily quantified, AQIs on their own are not a complete measure of quality.

The updates in this *Guide* are aimed at supporting the implementation of AQIs as part of the oversight and assessment process of the external auditor.

### **Sample AQIs**

For a non-exhaustive list of commonly used AQIs, please refer to the Appendix.

### **Implementation and Additional Resources**

Canadian experience has shown that audit committees are best served when they customize AQIs to their specific circumstances and information needs. Effective use of AQIs requires prior collaboration among audit committees, management and the external auditor to determine the AQIs relevant to their common objectives.

In order to facilitate the implementation of AQIs, we have prepared a broader document entitled, [\*Audit Committee Guide to Audit Quality Indicators\*](#). This guide provides a useful step-by-step process to help audit committees and management identify relevant AQIs, and establishes a general understanding of how they can be used to spark a discussion both internally and with the external auditor about improving audit quality.

For a practical application of AQIs as it relates to external auditor oversight, we have updated three of the Enhancing Audit Quality (EAQ) publications, including: this annual assessment tool, along with companion publications, [\*Periodic Comprehensive Review of the External Auditor – Tool for Audit Committees\*](#) and [\*Oversight of the External Auditor – Guidance for Audit Committees\*](#).

Finally, to help new audit committee members feel confident in understanding the various aspects of the external audit, CPA Canada has also developed a series of short training videos as follows:

1. [\*What External Auditors Do: A Primer for Audit Committee Members\*](#)
2. [\*What External Auditors Do: The Audit Process\*](#)
3. [\*What External Auditors Do: The Audit Process Continued\*](#)

By better understanding the external auditor's role, audit committee members may find it easier to select and evaluate AQIs and to assess the external auditors' performance.

# Introduction

A key oversight activity of audit committees is annually assessing the effectiveness of the external auditor. This annual assessment helps audit committees meet their responsibility to make an informed recommendation to the board on whether or not the external audit firm should be put forward in the proxy material for reappointment at the annual general meeting.

The annual assessment tool in this publication is intended to be used in years when the audit committee is not conducting a comprehensive review of the external auditor. When the audit committee is conducting a comprehensive review of the external auditor, the annual assessment in that year is conducted as part of the comprehensive review, using the tool contained in the companion publication [\*Periodic Comprehensive Review of the External Auditor – Tool for Audit Committees\*](#).

The annual assessment tool identifies three key factors of audit quality for the audit committee to consider and assess:

1. *Independence, objectivity and professional skepticism* – Do the auditors approach their work with objectivity to ensure they appropriately question and challenge management’s assertions in preparing the financial statements?
2. *Quality of the engagement team* – Does the audit firm put forward team members with the appropriate industry and technical skills to carry out an effective audit?
3. *Quality of communications and interactions with the external auditor* – Are the communications with the external auditor (written and oral) clear, concise and free of boilerplate language? Is the auditor open and frank, particularly in areas of significant judgments and estimates or when initial views differ from management?

Within each of these factors, a number of sub-questions are listed as possible indicators of audit quality. The audit committee should determine which of these indicators are most relevant in their circumstances and what information is available to assist them in their assessment. The accompanying notes provide more detail on the steps an audit committee may follow in conducting an annual assessment of the external auditor, including factors to consider at each step.

The annual assessment tool does not require audit committees to come to an overall measure of audit quality. Rather, it helps audit committees identify potential areas for improvement for the audit firm (and for the audit committee's own processes) and reach a final conclusion on whether the auditor should be reappointed or the audit should be put out for tender.

The tool's questions should be adapted to meet the entity's specific circumstances. Audit committees may identify questions that are particularly relevant to their circumstances on which they need to focus, and ignore those that are less relevant. Audit committees may need to address additional questions to focus more deeply on the most important matters for the annual assessment of the external auditor. The tool allows space for the addition of other questions and points to consider as necessary.

Reference can also be made to the companion document [Oversight of the External Auditor – Guidance for Audit Committees](#) which summarizes activities that audit committees perform to assess the external auditor, including the audit committee's annual assessment of the external auditor.

A possible step-by-step approach for using this tool is as follows:

1. *Determine the scope, timing and process*

The audit committee chair, perhaps in conjunction with other audit committee members, determines the scope, timing and process of the annual assessment. This includes determining what information the audit committee requires from entity personnel about the external auditor. It also includes determining what questions the audit committee needs to consider in conducting the assessment. The appropriate sections of the tool are amended by the audit committee chair to reflect these determinations.

A determination and selection of AQIs relevant to the audit committee's assessment of the external audit can also be done at this stage. For more information on how to do this, please see the [Audit Committee Guide to Audit Quality Indicators](#).

2. *Obtain input from entity personnel*  
Entity personnel, such as the chief executive officer (CEO), the chief financial officer (CFO) and internal auditors, complete the tool's Obtain input from entity personnel section and return it to the audit committee.
3. *Assess areas for audit committees to consider*  
The audit committee chair distributes to the audit committee the results of the prior-year annual assessment, the tool's amended Assess areas for the audit committee to consider section, and the input received from entity personnel. Audit committee members complete this section of the tool. At a meeting of the audit committee, members discuss each area of the assessment tool, comparing their views with those of entity personnel and the results of the prior-year annual assessment.
4. *Conclude on the annual assessment, and communicate the results*  
Following this discussion, the audit committee reaches a conclusion on whether to recommend the external auditor to the board for reappointment and identifies matters that should be reviewed with the external auditors to improve their future performance and effectiveness. The audit committee records and communicates the results of the annual assessment. Keeping a record assists the audit committee when performing a subsequent annual assessment or comprehensive review of the external auditor.

## 1. Determine the Scope, Timing, Process and Selection of AQIs

These determinations are key drivers for conducting an effective annual assessment. See section 1 of *Notes on Completing the Annual Assessment Tool* for more guidance.

Points to Consider	Observations
Consider the scope, timing and process for the annual assessment. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:	
1. Have there been significant changes that require changes to the assessment process this year?*	
2. What is the appropriate timing of the annual assessment in relation to the audit committee's planned meeting agendas?	



Points to Consider	Observations
3. Do the results of the prior-year assessments indicate areas that should be given particular focus this year?	
4. What additional information from the entity is needed to help the audit committee conduct the assessment?	
5. What information, if any, from the engagement team is needed to help the audit committee conduct the assessment (e.g., future changes to the engagement team)?	
6. What changes need to be made to other sections of this tool to reflect the approach to this year's annual assessment?	

\* Note that it may be appropriate to conduct a comprehensive review rather than an annual assessment of the external auditor, for example, if significant issues have already been identified, or if another triggering event has occurred, such as a change in the entity's corporate structure.

### Audit Quality Indicators

AQIs can provide audit committees with useful quantitative and qualitative information for the purpose of external auditor evaluation. The following table illustrates how AQIs can be used for your annual assessment of the external auditor.

Note that these are illustrative examples only. The selection of AQIs should be based on an organization's specific circumstances and information needs. For step-by-step guidance to help you identify relevant AQIs, refer to the [Audit Committee Guide to Audit Quality Indicators](#). A list of commonly used AQIs can also be found in the Appendix.

Audit Quality Factor	Example AQIs
<p><b>1. <i>Independence, objectivity and professional skepticism</i></b> Do the auditors approach their work with objectivity to ensure they question appropriately and challenge management's assertions made when preparing the financial statements?</p>	<p>Audit hours by risk</p> <ul style="list-style-type: none"> <li>The time spent by the engagement team on significant risk areas can help audit committees and management better understand the amount of effort spent in certain areas of the audit. This information can help determine whether a sufficient amount of time was allocated for the auditor to work objectively and challenge management's assertions.</li> </ul> <p>Reporting on independence matters</p> <ul style="list-style-type: none"> <li>A common way of assessing the auditor's independence is to report on independence breaches.</li> </ul>
<p><b>2. <i>Quality of the engagement team</i></b> Does the audit firm put forward team members with the appropriate industry and technical skills to carry out an effective audit?</p>	<p>Experience of engagement team</p> <ul style="list-style-type: none"> <li>A common way to help assess the quality of the engagement team is to understand the industry experience and client knowledge of individual team members. This can be measured by obtaining information about the number of years spent auditing the entity and/or companies in the same industry by each engagement team member.</li> </ul> <p>Specialist engagement</p> <ul style="list-style-type: none"> <li>Depending on the complexity of the audit, certain specialists / subject-matter experts may be required to complement the core engagement team. Where and how much (measured in hours) these specialists / subject-matter experts are used in the audit can be useful information for assessing the quality of the overall engagement team.</li> </ul>
<p><b>3. <i>Quality of communications and interactions with the external auditor</i></b> Are the communications with the external auditor (written and oral) clear, concise and free of boilerplate language? Is the auditor open and frank, particularly in areas of significant judgments and estimates or when initial views differ from those of management?</p>	<p>Communication with audit committee and/or management</p> <ul style="list-style-type: none"> <li>Consideration of the timing, format and content of communication from the auditor related specifically to the audit and/or wider issues of importance can help assess the effectiveness of the interactions with the auditor. Consider assigning a rating to the quality and timeliness of each communication.</li> </ul> <p>Audit progress milestones</p> <ul style="list-style-type: none"> <li>Reports on the timeliness of meeting audit milestones during the engagement can provide audit committees and management with better insight into the progress of the audit and any issues identified.</li> </ul>

It is important to note that AQIs on their own are not a complete measure of quality. This is because they will not necessarily convey the whole story since certain elements of audit quality such as the external auditor's professional skepticism cannot be easily quantified. AQIs are meant to be used as a tool to facilitate a more informed and meaningful conversation about audit quality among the audit committee, management and the external auditor.

Once AQIs have been selected, the audit committee chair will request the external auditor report on them. The results can then be circulated to entity personnel and the rest of the audit committee members as supplemental useful information for completing their respective sections of the assessment tool. Audit committees and management should also consider the results of AQIs used in overseeing the work of the external auditor, such as the review of the audit plan and monitoring the audit progress as additional information to help in their assessment.

## 2. Obtain Input from Entity Personnel

This section of the tool includes a number of questions the audit committee may want to ask entity personnel, such as the CEO, the CFO and internal auditors, to address. The audit committee needs to determine from whom input is required, specific questions to be addressed, and whether the audit committee wishes to obtain input in writing or through discussions. The audit committee may wish to address different questions to different personnel or to pose questions to different personnel in different ways. See section 2 of *Notes on Completing the Annual Assessment Tool* for more guidance.

### CEO and/or CFO

#### *Audit Quality Considerations*

Points to Consider	Observations
<ol style="list-style-type: none"> <li>1. Provide input on the <b>independence, objectivity and professional skepticism</b> of the external auditor. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:               <ol style="list-style-type: none"> <li>a. How does the external auditor demonstrate integrity, objectivity and professional skepticism, for example, by maintaining a respectful but questioning approach throughout the audit?</li> </ol> </li> </ol>	

Points to Consider	Observations
<p>b. How does the external auditor demonstrate independence, for example, by proactively discussing independence matters and reporting exceptions to its compliance with independence requirements?</p>	
<p>c. How forthright is the external auditor in dealing with difficult situations, for example, by proactively identifying, communicating and resolving technical issues?</p>	
<p>d. To what extent do you have concerns about the relationship between the external auditor and entity personnel that might affect the external auditor's independence, objectivity or professional skepticism?</p>	
<p>2. Provide input on the <b>quality of the engagement team</b> provided to conduct the external audit. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:</p>	
<p>a. How would you assess the technical competence and ability of the external auditor to translate knowledge into practice, for example, by using technical knowledge and independent judgment to provide realistic analysis of issues and by providing appropriate levels of competence across the team?</p>	
<p>b. How would you assess the external auditor's understanding of our business and industry, for example, by demonstrating an understanding of our specific business risks, processes, systems and operations?</p>	
<p>c. How sufficient are resources assigned by the external auditor to complete work in a timely manner, for example, by providing access to specialized expertise during the audit and assigning additional resources to the audit as necessary to complete work in a timely manner?</p>	
<p>d. To what extent has the engagement team consulted and used specialists on complex technical matters?</p>	

Points to Consider	Observations
<p>e. To what extent has the engagement partner maintained quality control over work performed in domestic locations or abroad?</p>	
<p>3. Provide input on the <b>communication and interaction with the external auditor</b>. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:</p>	
<p>a. How candid and complete was the dialogue between the engagement partner and management? How well did the engagement partner explain accounting and auditing issues?</p>	
<p>b. How effectively does the external auditor provide timely and informative communications about accounting and other relevant developments?</p>	
<p>c. How does the external auditor communicate about matters affecting the firm or its reputation, for example, by advising management on significant matters pertaining to the firm while respecting the confidentiality of other clients' information and by complying with professional standards and legal requirements?</p>	

### **Quality-of-Service Considerations**

Points to Consider	Observations
<p>Provide input on the <b>quality of service</b> provided by the external auditor. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:</p>	
<p>1. To what extent is the external auditor effective in completing the audit on a timely basis?</p>	
<p>2. To what extent does the external auditor keep management informed about the progress of the audit and difficulties encountered?</p>	
<p>3. To what extent has the engagement team maintained a respectful and professional attitude during the audit?</p>	

Points to Consider	Observations
4. To what extent is the external auditor proactive in identifying information requirements and timely in requesting information from management?	

### Internal Audit

Points to Consider	Observations
Provide input on the <b>relationship with the external auditor</b> . Some or all of the following questions may be relevant in the circumstances of the entity and the audit:	
1. To what extent have the external auditors considered how the work of the internal audit function can be used in the external audit?	
2. How would you characterize the working relationship between the external and internal auditors?	

### Other Input Requested from Entity Personnel by the Audit Committee

Input Requested	Observations
1.	
2.	
3.	

### 3. Assess Areas for the Audit Committee to Consider

This section of the tool sets out the audit quality and quality of service considerations addressed in an annual assessment. It incorporates specific questions for audit committees to consider in addressing each area. See section 3 of *Notes on Completing the Annual Assessment Tool* for more guidance.

#### Audit Quality Considerations

Points to Consider	Observations
<ol style="list-style-type: none"> <li>1. Assess the auditor's <b>independence, objectivity and professional skepticism</b>. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:               <ol style="list-style-type: none"> <li>a. How does the external auditor inform the audit committee about matters that might reasonably be thought to bear on the firm's independence, including exceptions to its compliance with independence requirements and its safeguards in place to detect independence issues?</li> <li>b. In obtaining the audit committee's pre-approval for non-audit services, what safeguards were in place to protect the external auditor's independence?</li> <li>c. How did the external auditor adjust the audit plan to respond to changing risks and circumstances?</li> <li>d. What steps does the engagement partner take to ensure that the engagement team exhibits the values, ethics and attitudes necessary to support a quality audit?</li> <li>e. How were significant differences in views, if any, between management and the external auditor resolved?</li> <li>f. What evidence is there that the engagement team challenges significant judgments made by management in preparing the financial statements?</li> </ol> </li> </ol>	

Points to Consider	Observations
g. How has the engagement team addressed potential risks of fraud (for example, incorporating an element of unpredictability into audit procedures during the period)?	
h. How has the engagement team responded to indicators, if any, of possible management bias in the preparation of the financial statements (for example, to achieve performance-based or incentive remuneration)?	
i. How would you assess the quality of the significant professional judgments made by the engagement team during the audits?	
j. Which of the entity's accounting policies or disclosures, if any, have been questioned by regulators such that the external auditor's independence, professional skepticism or judgment has been questioned?	
k. Did the engagement quality control reviewer (EQCR) raise specific concerns over any matters when assessing the significant judgments made by the engagement team? Would it be helpful to meet with the EQCR?	
l. Are the audit fees appropriate in relation to costs incurred to enable the performance of a quality audit?	
2. Assess the <b>quality of the engagement team</b> provided by the external auditor. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:	
a. How did the engagement partner and audit team ensure that the necessary knowledge and skills (entity-specific, industry, accounting, auditing) were dedicated to the audit?	
b. What evidence was there that the engagement partner devoted sufficient attention and leadership to the audit? How involved was the EQCR in the audit?	



Points to Consider	Observations
<p>c. If portions of the audit were performed by other teams in various domestic locations, or abroad by the firm's global network or other audit firms, how did the engagement partner assess their technical skills, experience and professional objectivity and maintain quality control over their work?</p>	
<p>d. To what extent are audit activities performed through offshoring arrangements? How did the engagement partner maintain quality control over the parties performing the activities?</p>	
<p>e. To what extent are the external and internal auditors working together constructively?</p>	
<p>3. Assess the <b>communication and interaction with the external auditor</b>. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:</p>	
<p>a. How candid and complete was the dialogue between the engagement partner, the audit committee and the audit committee chair? How well did the engagement partner explain accounting and auditing issues? How effective was the resolution of issues?</p>	
<p>b. How would you assess the external auditor's discussion about the quality of the entity's financial reporting, including the reasonableness of accounting estimates and judgments, appropriateness of the accounting policies and adequacy of the disclosures?</p>	
<p>c. During in camera sessions, what is your assessment of how the external auditor discussed sensitive issues (for example, were concerns about management's reporting processes, internal control over financial reporting or the quality of the entity's financial management team discussed in a timely, candid and professional manner)?</p>	

Points to Consider	Observations
d. How promptly did the audit engagement partner alert the audit committee if the engagement team did not receive sufficient cooperation?	
e. How well did the external auditor inform the audit committee of current developments in accounting and auditing standards relevant to the entity's financial statements and their potential impact on the audit?	

### Quality-of-Service Considerations

Points to Consider	Observations
4. Assess the <b>quality of service</b> provided by the external auditor. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:	
a. During the audit, how well did the external auditor meet the agreed-upon performance criteria, such as the engagement letter and audit scope? How well did the external auditor meet its commitments, for example, by meeting agreed-upon performance delivery dates and multiple reporting deadlines and by being available and accessible to management and the audit committee?	
b. How would you assess the professionalism of the audit partner and the engagement team?	
c. How responsive and communicative is the external auditor, for example, in soliciting input relative to business risks or issues that might impact the audit plan?	
d. How proactive is the external auditor in identifying opportunities and risks, for example, by anticipating and providing insights and approaches for potential business issues and improving internal controls?	

Points to Consider	Observations
<p>e. How would you assess the value for money delivered by the external audit; for example, do the audit fees fairly reflect the cost of the services provided given the size, complexity and risks of the entity and a cost-effective quality audit?</p>	
<p>f. How would you assess the reasonableness of the explanations for any changes to fees (for example, change in scope of work) communicated to the audit committee?</p>	

### CPAB Inspection Findings

Points to Consider	Observations
<p>5. Assess the implications of CPAB inspection findings on the external audit's quality. Some or all of the following questions may be relevant in the circumstances of the entity and the audit:</p>	
<p>a. What evidence is there that the external auditor demonstrated an appropriate level of focus on audit quality arising from CPAB inspection findings?</p>	
<p>b. How have any systemic audit quality issues identified by CPAB in its public report been considered by the audit firm and the engagement team?</p>	
<p>c. If CPAB performed an inspection of the entity's audit file, were there significant inspection findings? If so, how has the external auditor responded? Has there been an appropriate response to address the key issues in the current year? Has the auditor changed the future audit approach to improve the audit in future years?</p>	

### Further items that the audit committee needs to consider in the circumstances

Item	Observations
1.	
2.	
3.	

## 4. Conclude on the Annual Assessment and Communicate the Results

This section of the tool sets out considerations about the audit committee's conclusions from the annual assessment and how the audit committee will record and communicate the results. See section 4 of *Notes on Completing the Annual Assessment Tool* for more guidance.

Points to Consider	Observations
<p><b>Conclude on the results of the annual assessment and recommend to the board</b> whether to reappoint the auditor for a further year.* Consider how the results will be recorded and communicated. Consider the following questions:</p>	
1. Has sufficient information been obtained to reach a conclusion?	
2. What implications, if any, are there for the timing of the next comprehensive review of the external auditor?*	
3. How should the audit committee communicate the results to the board – in written or oral form?	
4. How are the results to be recorded for future reference during an annual assessment or comprehensive review?	

\* Note that if significant issues are identified during the annual assessment or if the audit committee is considering replacing the audit firm or putting the audit out for tender, it may be appropriate to conduct a comprehensive review before reaching a final conclusion. Doing so enables the audit committee to comprehensively evaluate the audit firm over a longer time period.

**Items to be raised with the auditor for follow-up or future changes**

Item	Person Responsible for Follow-up
1.	
2.	
3.	

**Potential future changes to the annual assessment or other audit committee process**

Item	Person Responsible for Follow-up
1.	
2.	
3.	

## Notes on Completing the Annual Assessment Tool

### 1. Determine the scope, timing and process

- a. It makes good sense for audit committee members to continuously evaluate the external auditor's performance throughout the audit, for example, by noting the external auditor's skepticism in evaluating unusual transactions and responsiveness to issues. These contemporaneous assessments provide important input to the formal annual assessment process. They may also save time when completing the annual assessment.
- b. Audit committees should plan their meeting agendas at least a year in advance to ensure they fulfill all their responsibilities. The annual assessment process is usually completed in time for the audit committee to be able to recommend to the board whether or not the external auditor should be put forward in the proxy for reappointment at the annual general meeting. The audit committee needs to determine the most appropriately timed meeting for discussion of the external auditor's annual assessment. It is best to conduct the annual assessment while the most recent audit is still fresh in audit committee members' minds. Further, it is often advantageous to discuss the annual assessment and the current year's audit strategy at the same meeting so the current year's audit strategy can incorporate suggestions for improvement from the annual assessment.
- c. The audit committee chair plays a key role in assisting the audit committee follow an appropriate process for the annual assessment. Because the audit committee chair typically has the most interaction with the external auditors, the chair will be best positioned to identify whom to ask for input and the most effective means of obtaining and summarizing that input.
- d. To ensure that all views are considered, audit committee members may wish to finalize their assessment during group discussions (as opposed to collecting their comments separately) during formal committee meetings or conference calls. Completing the annual assessment tool may require more effort the first time the audit committee conducts an annual assessment. In following years, the nature and extent of the annual assessment may vary with the circumstances and will be influenced by such things as the engagement team's continuity, changes to the audit's scope, and prior-year assessment results.

- e. In conducting the annual assessment of the external auditor, the audit committee takes into account audit quality and quality of service considerations. **Audit quality indicators may help in this regard, so care should be taken to select, evaluate and discuss AQIs in an appropriate manner.** Audit quality considerations are of primary importance because they reflect whether the external audit can take place in an environment that promotes a quality audit.
- f. Quality of service considerations focus primarily on how the external audit, in terms of being a professional service, was conducted. Although treated separately from audit quality considerations, quality of service considerations can also influence audit quality. For example, if the external auditor's behaviour creates friction with management, the behaviour may affect the open and constructive relationship between the auditor and management needed to enhance audit quality.

## 2. Obtain input from entity personnel

- g. The audit committee may find the views of others within the entity helpful in confirming or contradicting the audit committee's own assessment of the external auditor's independence, objectivity and professional skepticism, sufficiency of audit firm resources, and communication and interaction.

## 3. Assess areas for the audit committee to consider

- h. Audit committees should consider the following factors, discussed below, when performing the annual assessment of the external auditor:
- independence, objectivity and professional skepticism
  - quality of the engagement team provided by the external auditor
  - communication and interaction with the external auditor
  - CPAB inspection findings

### ***Independence, objectivity and professional skepticism***

- i. The external auditor must be independent of the issuer. Audit committees should be familiar with the statutory and regulatory independence requirements for external auditors, including requirements that the external auditor advise the audit committee of any services or relationships that reasonably can be thought to bear on the firm's independence.

- j. Technical competence alone is not enough to ensure a high-quality audit. The external auditor also must have high levels of objectivity and professional skepticism and the time to fully exercise them. Professional skepticism includes being alert to indicators such as:
- contradictory audit evidence
  - information that questions the reliability of documents
  - responses to inquiries that cannot be corroborated
  - conditions that may indicate possible fraud
  - circumstances that call for audit procedures beyond those required by auditing standards
- k. Professional skepticism also includes the willingness to challenge management on the assertions and representations they make in preparing the financial statements.
- l. The audit committee's interactions with the external auditor during the audit provide a number of opportunities to evaluate whether the external auditor is demonstrating integrity, objectivity and professional skepticism. For example, the use of estimates and judgments in the financial statements and related disclosures (such as fair value, impairment) continues to be an important component of financial reporting. The external auditor must be able to evaluate the methods and assumptions used and challenge, where necessary, management's assumptions and application of accounting policies, including the completeness and transparency of the related disclosures.
- m. The audit committee should recognize that the external auditor applies professional judgment throughout the audit, for example, when determining materiality and audit risk, choosing the nature, timing and extent of audit procedures, and evaluating management's judgments in applying the financial reporting framework. In discussing the basis for significant judgments made by the auditor during the audit, the audit committee should assess whether the auditor has made informed judgments using an appropriate understanding of the entity's business, including business risks.
- n. As required by Canadian Auditing Standards (CASs), an engagement quality control review is mandatory for listed entities and other engagements identified by the audit firm. The EQCR is not part of the engagement team but is generally a partner in the audit firm with sufficient experience and authority to objectively evaluate the significant judgments of the engagement team and its conclusions in the



external auditor's report. The EQCR often has no direct interaction with the entity's management or audit committee. However, the audit committee could find it helpful to ask the engagement partner about any matters in which the EQCR was involved during the audit and any concerns the EQCR raised in assessing the engagement team's judgments. Further, because of the EQCR's experience and involvement in the audit, the EQCR may be a valuable resource for the audit committee, particularly regarding controversial issues.

***Quality of the engagement team provided by the external auditor***

- o. The engagement team should have performed risk assessment at the outset of the audit, including an assessment of fraud risk. During the engagement, the external auditor should have obtained an understanding of the entity's business, industry, and the impact of the economic environment on the entity. Moreover, the external auditor should have identified and responded to any auditing and accounting issues that arose from such things as changes in the entity or its industry or in applicable accounting and auditing requirements. The audit committee needs to consider whether the engagement team has the knowledge and skills, including access to appropriate specialists, necessary to perform the audit.
- p. Another consideration is the quality of the engagement teams that perform portions of the audit in various domestic locations or abroad by the firm's global network or other audit firms. For example, the audit committee should consider whether an appropriate engagement team is appointed with respect to the audit of operations in higher-risk foreign jurisdictions, including such things as:
  - the engagement team's ability to communicate effectively in the language used in the foreign jurisdiction
  - the team's understanding of business customs and practices and working knowledge of the business environment in which the entity operates in that jurisdiction
  - the team's ability to travel to and within the jurisdiction to conduct the audit.
- q. In recent years, some audit firms have begun transferring certain audit tasks typically performed by domestic audit teams to audit firm staff at overseas locations. This is commonly referred to as "offshoring." If

offshoring has been used extensively in the audit, the audit committee should consider whether it needs to gain a deeper understanding how the quality of such work is controlled.

***Communication and interaction with the external auditor***

- r. Frequent and open communication between the audit committee and the external auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the entity's financial reporting processes. The quality of communications also provides opportunities to assess the external auditor's performance. While the external auditor should communicate with the audit committee as significant issues arise, the external auditor ordinarily should meet with the audit committee frequently enough to give the audit committee a complete understanding of the stages of the audit cycle (for example, planning, completion of final procedures, and, if applicable, completion of interim procedures). Such communications should focus on the key accounting or auditing issues that, in the external auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, as well as any questions or concerns of the audit committee.
- s. CASs identify a number of matters the external auditor must discuss with the audit committee. Audit committees should be familiar with those requirements. They should consider not only whether the external auditor made all of the required communications but also, the level of openness and quality of these communications, whether in management's presence or in camera.

***CPAB inspection findings***

- t. The audit committee should read CPAB's most recent annual public report and periodic newsletters to become aware of audit quality issues. The audit committee should discuss with the external auditor whether there were matters of systemic quality concern that may be relevant to the audit firm and/or entity, and relevant actions of the audit firm, and the engagement team in particular, that will affect future audits of the entity.
- u. The audit committee should discuss with the external auditor the auditor's communication when a CPAB inspection report has been issued on the audit file relating to the entity. When there have been significant inspection findings, these should be discussed with the external auditor, including the nature of the finding, the cause of the deficiency and how

the deficiency has been resolved, including future changes to be made to the audit. The audit committee may also consider the implications for its own processes in terms of follow up with the external auditor and the periodic comprehensive review.

#### 4. Conclude on the annual assessment and communicate the results

- v. When the annual assessment is complete, the audit committee will be in a position to recommend whether the board should nominate the external auditor for reappointment for a further year. In some circumstances, the audit committee may decide it needs more information to reach a conclusion and perform some or all aspects of a comprehensive review. In this case, the audit committee should refer to the comprehensive review tool in the companion publication *Periodic Comprehensive Review of the [Periodic Comprehensive Review of the External Auditor: Tool for Audit Committees](#)*.
- w. The audit committee should present to the board the results of the annual assessment, setting out the process it undertook and the rationale for its recommendations. The audit committee's presentation could be either oral or in writing, and the audit committee should consider which form would best engage the board in understanding the report. In some cases, a written report may be sufficient. In other cases, the board may need to discuss the annual assessment results in detail with the audit committee chair to gain an understanding of the key matters raised during the assessment and how the audit committee reached its conclusions. Keeping a record of each annual assessment, for example, in written reports or in meeting minutes, may assist the audit committee when performing a subsequent annual assessment or comprehensive review of the external auditor.
- x. During the annual assessment, the audit committee may have identified matters to be raised with the auditor for immediate follow-up or changes in the future. These can be included in the *Items to be raised with the auditor for follow-up or future changes* section of the annual assessment tool and reviewed with the external auditors to help them continually improve their effectiveness and performance.
- y. The audit committee should consider whether there are actions it should take in the coming year to improve its own processes by completing the *Potential future changes to the annual assessment or other audit committee process* section of the annual assessment tool.

## Appendix – Example AQIs

Type	Indicator	Example Definitions
Engagement Team Indicators	<b>experience of engagement team</b>	delivery of agreed upon team skills (industry/specialty/client knowledge) years of audit experience of key members of the engagement team
	<b>training and professional development</b>	number of hours and types of professional development and technical training attended by key engagement team members
	<b>turnover of engagement team</b>	turnover rates of key engagement team members and/or level
	<b>partner / manager involvement</b>	percentage of audit hours carried out by senior engagement team members compared to the entire engagement team
	<b>partner workload</b>	information about the level of work for which key engagement partners are responsible and the number of claims on their attention

Type	Indicator	Example Definitions
<b>Audit Execution Indicators</b>	<b>audit hours by risk</b>	time spent by the engagement team on significant risk areas
	<b>timing of audit execution</b>	audit hours by phase (planning, interim, year-end)
	<b>audit progress milestones</b>	mapping the timeline for completion of the audit to key milestones within the process
	<b>technology in the audit</b>	use of technology initiatives in the audit, including information about areas of use, types of tools, number of hours, etc.
	<b>specialist engagement</b>	where and how much (measured in hours) persons with "specialized skill and knowledge" are used in the audit
	<b>service delivery centres</b>	amount of audit work centralized at service centres
<b>Management Indicators</b>	<b>management deliverables</b>	success in maintaining agreed-upon deliverables schedule from management to the auditor
	<b>remediation of control deficiencies</b>	efficiency of remediating control deficiencies
	<b>reliance on controls</b>	planned / unplanned reliance on internal controls
<b>Firm Level Indicators</b>	<b>results of inspections</b>	results of internal and/or external inspections specific to the engagement and/or to the audit firm generally (i.e., CPAB inspection findings)
	<b>independence</b>	results of independence findings specific to the engagement and/or to the audit firm generally
	<b>reputation</b>	reputation based upon news reports
	<b>tone at the top</b>	tone at the top determined by audit firm people-survey results

Type	Indicator	Example Definitions
Client Service Indicators	<b>communication with audit committee and/or management</b>	effective and timely communications among the auditor and the audit committee and/or management related specifically to the audit and/or wider issues of importance (i.e., regulatory and accounting changes)
	<b>sharing of insights</b>	number and quality of insights gained and shared with management and the audit committee



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