

# Oversight of the External Auditor

## **GUIDANCE FOR AUDIT COMMITTEES**

January 2014, updated September 2018



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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 *Guide*, the [\*Annual Assessment of the External Auditor—Tool for Audit Committees\*](#) and [\*Periodic Comprehensive Review of the External Auditor—Tool for Audit Committees\*](#) publications.

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.

# Foreword

Audit quality is increasingly in the spotlight as a key element of the financial reporting process. Through effective oversight of the work of the external auditor, audit committees can contribute to the audit's overall quality while safeguarding the external auditor's independence. With this in mind, Chartered Professional Accountants of Canada (CPA Canada), the Canadian Public Accountability Board (CPAB) and the Institute of Corporate Directors (ICD) are collaborating to develop guidance and tools to help audit committees perform their oversight activities in ways that consistently enhance audit quality.

In this publication we summarize certain responsibilities of audit committees of Canadian reporting issuers and the activities that help audit committees meet those responsibilities. We also present best practice guidance for each activity. The guidance will be of particular interest to those wishing to gain an overall understanding of the audit committee's role in overseeing the work of the external auditor.

The guidance also provides useful context for two companion publications, [\*Annual Assessment of the External Auditor\*](#) and [\*Periodic Comprehensive Review of the External Auditor\*](#), that feature practical tools for audit committees to use in conducting annual assessments and periodic comprehensive reviews (at least once every five years) of the external auditor.

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 global financial crisis that erupted in 2008 threatened the viability of many financial institutions and the fiscal stability of several countries. During the crisis, numerous policymakers, regulators and others proposed significant

changes to the financial system. Although external auditors were not seen as having caused corporate failures, questions were raised about their role. While Canada weathered the crisis better than many countries, it is not immune to the changes taking place in other jurisdictions. It is important that Canada's audit process and audit quality are consistent and comparable internationally.

Concerns have been raised about familiarity and self-interest threats between external auditors and the entities they audit at the institutional level. Such threats have become known as “institutional” familiarity threats. There is a perception that, after an extended period of time, the relationships between external auditors and their clients become too close. This familiarity may create a threat to independence that impedes the ability of the external auditor—and specifically the engagement team members—from exercising appropriate professional skepticism.

The Enhancing Audit Quality (EAQ) initiative, a joint project of CPA Canada and CPAB, examined how to enhance audit quality in light of global developments.<sup>1</sup> The initiative considered various alternatives for safeguarding against institutional familiarity threats, ranging from subjecting external auditors to term limits to calling for mandatory tendering of audits. The initiative's report *Enhancing Audit Quality: Canadian Perspectives*, concludes that the alternative most likely to enhance audit quality is for audit committees to carry out a comprehensive review of the external auditor at least every five years. Such a comprehensive review is considered to be in the best interests of stakeholders, as opposed to a “one size fits all” requirement that does not account for the particular circumstances of the entity and its stakeholders

## Acknowledgments

This guidance incorporates, and builds on, the discussion papers and final report of the EAQ initiative.

The guidance was developed with the aid of an [Advisory Group](#) of experienced audit committee members and others with an interest in audit committee matters. The 2018 updates were performed by a separate group, who are acknowledged in the [Audit Committee Guide to Audit Quality Indicators](#) publication. The guidance is non-authoritative and has not been endorsed, approved or otherwise acted on by any board or committee of CPA Canada, CPAB, the ICD, or by the Canadian Securities Administrators.

<sup>1</sup> The EAQ initiative, *Enhancing Audit Quality: Canadian Perspectives*, was a collaboration of the Chartered Professional Accountants of Canada (CPA Canada) and the Canadian Public Accountability Board (CPAB) to examine how to enhance audit quality in light of various global developments. Further information about the EAQ initiative can be found at [www.cpacanada.ca/enhancingauditquality](http://www.cpacanada.ca/enhancingauditquality).

### **Providing Input on This Guidance**

The Advisory Group is interested in receiving input from stakeholders on the guidance set out in this document. Comments and questions should be sent to: [auditquality@cpacanada.ca](mailto:auditquality@cpacanada.ca).



# Introduction

1. National Instrument 52-110 *Audit Committees* (NI 52-110) sets out certain rules that apply to audit committees of Canadian reporting issuers. Reporting issuers that must apply NI 52-110 are required, amongst other things, to recommend to the board of directors the external auditor to be nominated to perform the audit of the entity's financial statements, and for to oversee the work of the external auditor. NI 52-110 neither defines what "overseeing the work of the external auditor" means nor specifies what audit committees are expected to do in discharging these responsibilities. Clearly, however, audit committees need to periodically assess the external auditor and factor audit quality considerations into their oversight. Our guidance in this publication aims to help audit committees fulfill these responsibilities and also deal with other aspects of working with their external auditors with the goal of enhancing audit quality.
2. NI 52-110 specifies that an audit committee must have at least three members, all of whom must be independent, financially literate, and a director of the entity. Venture issuers are exempt from these requirements, and there are certain exemptions for other issuers. Some audit committees, especially those exempt from the financial literacy requirement, may be challenged to apply this guidance with current resources. These audit committees may wish to reconsider their composition and whether it would be advisable to include member(s) with auditing experience.
3. Audit committees should ensure that they are familiar with any relevant supplemental regulatory requirements that apply to certain industries, such as financial institutions, which this guidance does not address.
4. Audit committees are in no way tasked with the execution of the audit. Their responsibility is limited to overseeing the audit function. As with the scope of the audit itself, the implementation of this guidance should be

scaled to suit the size and complexity of an entity's operations. Thus the scope of oversight activities performed by audit committees of large multinational corporations with complex business operations will differ from those of small companies operating in a single market.

5. Effective oversight of the external auditor's work should help safeguard the auditor's independence while contributing to the audit's overall quality. This oversight will help integrate the audit committee's knowledge and concerns into the audit process

## **The Audit Committee's Perspective: What Is Audit Quality?**

6. Audit quality is a complex subject. There is no universally recognized definition or analysis of the term. As a discipline, audit relies on competent individuals applying their experience, integrity, objectivity and professional skepticism to make appropriate judgments. Perspectives on audit quality vary among stakeholders (e.g., management, audit committees, audit firms, regulators), and perceptions are influenced by the stakeholder's level of direct involvement in, and access to information relevant to, the audit.
7. The International Auditing and Assurance Standards Board's (IAASB) framework for audit quality<sup>2</sup> describes the input, process and output factors that contribute to audit quality for financial statement audits at the engagement, audit firm and national levels. The framework states that the objective of an audit of financial statements is for the auditor to form an opinion on the financial statements based on having obtained sufficient appropriate audit evidence about whether the financial statements are free from material misstatement and report in accordance with the auditor's findings. Under this framework, a quality audit is likely to be achieved by an engagement team that:
  - exhibits appropriate values, ethics and attitudes
  - has the requisite knowledge, skills and experience and sufficient time allocated to perform the audit work
  - applies a rigorous audit process and quality control procedures that complies with law, regulation and applicable standards
  - provides useful and timely reports
  - interacts appropriately with relevant stakeholders

2 The IAASB publication A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality can be found at: [www.ifac.org/publications-resources/framework-audit-quality](http://www.ifac.org/publications-resources/framework-audit-quality)

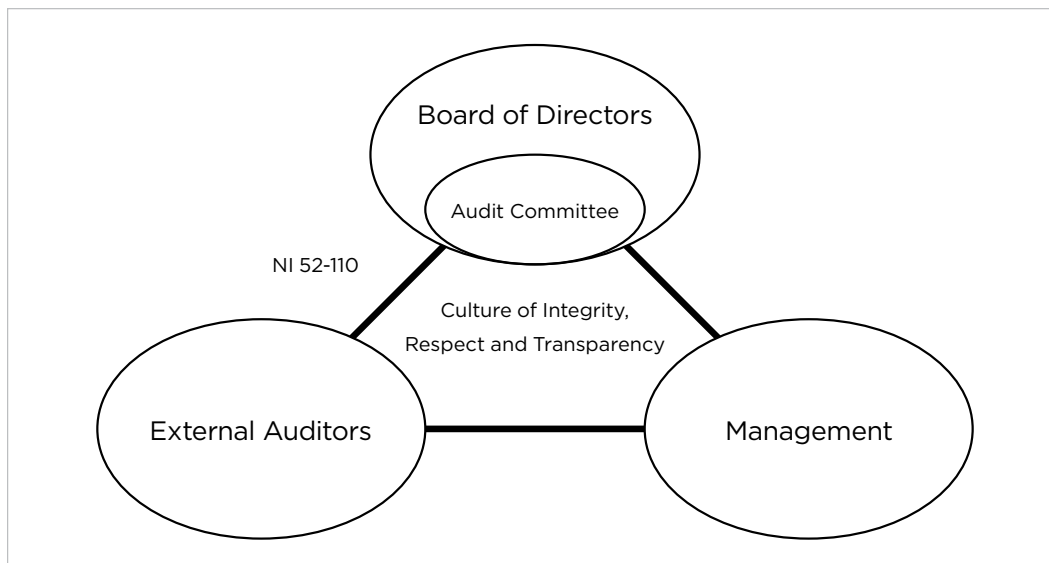
8. The IAASB's framework provided a useful foundation in developing this publication's guidance for audit committees when considering audit quality from their perspective. CPAB inspection findings may provide the audit committee with additional useful information about audit quality from the regulator's perspective.
9. An audit involves many different procedures that focus on different assertions within the financial statements, often carried out at different times of the year and in different locations. Considerable judgment is required, and there may be alternative ways to obtain audit evidence. Audit committees are not expected to understand the nature, timing and extent of all audit procedures that the external auditor performs; however, an audit committee may obtain useful insights into the quality of the audit process by performing the oversight activities described in this publication.

# Annual Oversight Activities

## Monitoring the Effectiveness of the Financial Reporting Environment

10. Effectiveness of the financial reporting environment is maximized when the audit committee, the external auditors and management are equally committed to:
- ensuring the integrity of the issuer’s financial reporting
  - understanding and respecting each other’s roles and responsibilities
  - establishing constructive working relationships among all three parties.
11. Figure 1 shows the relationships among the parties involved in the financial reporting process:

**FIGURE 1: KEY RELATIONSHIPS IN FINANCIAL REPORTING GOVERNANCE**



12. Candid communication among the parties involved in an issuer's financial reporting is fundamental to quality financial reporting. This communication requires constant monitoring, evaluation and assessment, and a commitment to take corrective action if required.
13. As Figure 1 illustrates, the audit committee directly communicates with management and the external auditors,<sup>3</sup> and also oversees the nature of the interactions between management and the external auditors.<sup>4</sup>
14. Under this framework, mutually respectful working relationships between the external auditors and the audit committee - and especially between the engagement partner and the audit committee chair - are important.
15. The audit committee must set the proper tone at the top by establishing the expectation of open, candid and direct communication among management, the external auditors and the audit committee. In its 2012 public report,<sup>5</sup> CPAB emphasized that the audit committee plays a critical role in creating the right environment for quality auditing. The audit committee should create an environment that accommodates an open discussion in a culture of integrity, respect and transparency between management and the auditors.
16. Professional auditing standards require external auditors to formally report to the audit committee on their independence and a number of other items, as noted later in this guidance. Equally important are regular informal communications with the audit committee chair between meetings, discussions at audit committee meetings, and candid, in camera discussion of issues during audit committee meetings. The audit committee should state its expectation that the external auditors conduct the audit with appropriate professional skepticism, recognizing it as a key contributor to audit quality. The audit committee should monitor communications and intervene appropriately if the external auditors do not appear to exercise such skepticism or if management does not respond appropriately.

3 For the purposes of Figure 1, "management" includes the internal audit function. An internal audit function's organizational status, authority and accountability can vary from entity to entity. In some cases, the internal audit function reports directly to the audit committee.

4 In this document, the relationship between management and the external auditors is described in the context of effective communication during the audit's execution and not in the context of a relationship to sell services.

5 Canadian Public Accountability Board, 2012 Public Report, *Effective Regulation—Sustainable Solutions* (Toronto: Canadian Public Accountability Board Oversight Program, April 2013), p. 10.

17. Integrity and candour on the part of both management and external auditors are essential for the effective operation of the financial reporting process. Professional skepticism and mutual respect helps ensure a free flow of information so that, for example, there are no impediments to the external auditors' access to information relevant to the audit's execution. Potential benefits of this relationship to management may include more direct communication of any audit findings and more receptiveness toward external auditor commentary that could improve the effectiveness of internal controls and the quality of management's financial reporting. Management should respect that external auditors approach audits with professional skepticism, which requires a questioning mind and a watchful eye for information that is contrary to management's representations.
18. Audit committees should be on the lookout for the following potential warning signs, which may indicate that the culture of integrity in the issuer's financial reporting governance environment is weak or deteriorating.
  - Communications are formal, carefully scripted and lack substance.
  - The external auditors do not appear to be exercising healthy professional skepticism in conducting the audit.
  - The external auditors' suspicions are heightened, and they are aggressively challenging management's estimates and valuations.
  - Management is unduly defensive about issues raised by the external auditors or about their requests for further information and documentation to support management's estimates and judgments.
  - The external auditors encounter unanticipated management restrictions.
  - Management is unwilling to document and support various accounting estimates and judgments or to meet the external auditors' request for an assessment of the entity's ability to continue as a going concern.
  - Management does not view the external auditors as a source of useful input on continuous improvement of the quality of the issuer's financial reporting.
  - Management seeks to overly control the relationship with the external auditors and forces the external auditors to rely on particular members of management for information.
  - Differences of opinion on accounting matters rapidly increase the tension between the external auditors and management, with both parties adopting defensive, hard-line positions.
  - Changes in management do not significantly change the dynamics of the relationship; suspicion and tension remains or continues to escalate.
19. Audit committees should exercise similar oversight over the work of the chief financial officer (CFO), the internal audit function, the finance

function and other members of management involved in the financial reporting process. Audit committees should ensure that they can rely on the integrity of the CFO and that the chief executive officer (CEO) and CFO are creating a culture of integrity in the financial reporting function and throughout the organization.

20. When the audit committee senses that communications between management and the external auditors are starting to deteriorate or that risks to the organization's culture of integrity in the financial reporting function are increasing, the audit committee should take action. Such risks should be reported to the board of directors, along with recommendations for improvement. Should the audit committee not act on such red flags, lapses in integrity or competence may be overlooked, heightening the risk of material omissions or misstatements in the issuer's financial reporting.
21. The absence of a respectful professional relationship between any combination of the audit committee, management and the external auditors is detrimental to the independent audit process. The audit committee can contribute to a positive audit environment by fostering and monitoring an appropriate tone in communications among the three parties.
22. AQIs to assist audit committees in monitoring the effectiveness of the financial reporting environment:
  - Remediation of control deficiencies
    - An AQI around the remediation of previously identified control deficiencies can be an indicator as to the effectiveness of internal controls, which directly impacts the quality of management's financial reporting. Consider requesting information on how many control deficiencies have been identified by management and/or the auditor in the period, as well as the rate of remediation. Further context on how certain control deficiencies have been remediated can also be useful to the audit committee's understanding.
  - Sharing of insights
    - The external auditor's sharing of insights with the audit committee and management can indicate the level of commitment to continuous improvement and the overall effectiveness of the financial reporting environment. To measure this, consider requesting information about the number and quality of shared insights and compare this with the number of those relevant best practices that have been implemented by the entity.

\*Refer to the Appendix for a list of other commonly used AQIs. For more information on AQIs, including guidance on how to select AQIs, please see the [Audit Committee Guide to Audit Quality Indicators](#)

## Considering the Results of CPAB Inspections

23. As Canada's independent audit regulator, CPAB conducts inspections of the audit firms performing audits of reporting issuers. CPAB's inspections focus primarily on the quality of the audit work as evidenced in the audit files. CPAB does not inspect all audit files of all reporting issuers audited by an audit firm, nor does CPAB inspect the entire audit files of the issuers it has chosen to inspect. CPAB focuses generally on material high-risk financial statement items that require more complex estimates and judgments.
24. CPAB reports its findings to the audit firm of an inspection of an individual reporting issuer audit. Following each inspection of a firm, CPAB issues to the firm a private report setting out its findings on quality control processes, individual file review findings and mandatory recommendations that must be implemented. Annually, CPAB issues a public report on its inspections of the quality of audits conducted by public accounting firms. In the future, audit committees will receive CPAB's annual public report and, if CPAB has inspected the audit file of a reporting issuer, the issuer's audit committee will receive specific information about that inspection.

## While Annual Public Report

25. CPAB's annual public report summarizes firm-level inspection themes, recurring issues, trends and emerging issues. The firms or entities whose audit files gave rise to the findings are not identified. CPAB also prepares a summary of key messages from the public report specifically tailored to the interests of audit committees. Under the terms of a protocol that CPAB has developed with the audit firms, the external auditor would provide CPAB's public report to the audit committee.
26. The audit committee should read CPAB's most recent annual public report and periodic newsletters for audit committees to become aware of audit quality issues. The audit committee should discuss with the external auditor whether systemic audit quality issues might be relevant to the audit firm and/or entity. The audit committee should also ask what actions the audit firm, and the engagement team in particular, are taking that could affect the entity's future audits.



## Engagement-Specific Findings

27. CPAB has developed a protocol with the audit firms for communicating inspection findings relating to the audit of a particular reporting issuer to its audit committee. Under this protocol, the external auditor will provide the audit committee with specific required information on a confidential basis. This information will include a description of the focus areas selected for inspection by CPAB, whether or not there are any significant inspection findings reportable to the audit committee. If there are significant inspection findings, the audit committee will also receive a description of any significant inspection finding(s), together with the audit firm's response and their disposition.
28. When CPAB has issued an inspection report on an entity's audit file, the entity's audit committee and the external auditor should discuss the external auditor's communication. In the event of significant inspection findings, the audit committee should ask the external auditor about the nature of the finding, the cause of the deficiency and how the deficiency has been resolved, including any changes to be made in future audits. The audit committee also may consider the implications to its own processes for following up with the external auditor and for future annual assessments or the comprehensive review of the external auditor.
29. More information about CPAB, its inspection processes and the protocol with the audit firms can be found at: [www.cpab-ccrc.ca/en/topics/CPAB-Protocol/Pages/default.aspx](http://www.cpab-ccrc.ca/en/topics/CPAB-Protocol/Pages/default.aspx).
30. AQI to assist audit committees in monitoring the results of internal and external inspections:
  - Results of internal and external inspections:
    - Consider requesting from the external auditor the results of internal and external inspections specific to the engagement and/or the audit firm. This information can form the basis of further discussion between the audit committee and the external auditor around significant inspection findings.

\*Refer to the Appendix for a list of other commonly used AQIs. For more information on AQIs, including guidance on how to select AQIs, please see the [Audit Committee Guide to Audit Quality Indicators](#)

## Reviewing the Overall Audit Strategy

31. Professional standards require the external auditors to develop an overall audit strategy and a detailed audit plan governing the nature and timing of the audit procedures and resources required. The external auditors should review their proposed audit strategy with the audit committee early in the financial reporting year. In some cases, it may be appropriate for an audit committee to conduct a preliminary meeting with the external auditor to discuss the overall audit strategy and a second meeting to address the audit plan in detail. These discussions may occur at special audit committee meetings or as part of a regular quarterly meeting in cases where the external auditors are engaged to perform quarterly review procedures.
32. A preliminary meeting may involve a discussion of:
  - the reports to be issued on financial statements, for example, on the consolidated entity, the parent entity and subsidiaries
  - the auditor's other reporting responsibilities, for example, to regulators
  - the general approach to the audit and timing, including the composition of the engagement team
  - the utilization of other firms within or outside the auditor's network of affiliates
  - the extent to which audit activities are performed offshore and the quality controls over those activities
  - geographical locations to be visited by the group auditor
  - the results of any CPAB inspection findings that may affect the audit strategy for the current year
  - the results of the audit committee's annual assessment of the external auditor for the prior year that may affect the audit strategy for the current year.
33. For smaller or less complex entities, the audit committee may combine discussion of the overall audit strategy and detailed audit plan in one meeting.
34. In reviewing the overall audit strategy, the audit committee should focus its oversight on:
  - the rationale supporting critical audit planning decisions and choices
  - the timing of major audit activities
  - whether the external auditors' analysis of the entity's specific business risks demonstrates sufficient knowledge of the business
  - key audit deliverables
  - the resources needed to execute the audit plan.

35. The audit committee and the external auditors should establish a communication protocol that ensures sufficient transparency and frequency of opportunities for the audit committee to oversee the external auditors' work.

## **Reviewing the Audit Plan and Assessing the Reasonableness of the Audit Fee**

36. To execute a quality audit, external auditors must first understand the entity's business risks. In reviewing the audit plan, the audit committee should share its knowledge of significant business risks with the external auditors to ensure that their analysis and demonstration of knowledge of the business is congruent with that of the audit committee and adequately dealt with in the audit plan.
37. Audit committees may expect the proposed audit plan to address the following items:
- identification and timeline for communication of key deliverables, such as quarterly review results, progress reports on key audit areas, subsidiary audited financial statements, and annual financial statement audit opinion
  - materiality thresholds to be used in planning and performing the audit
  - assessment of significant financial reporting risks and how the audit plan addresses them
  - extent of reliance on and testing of internal controls over financial reporting
  - extent of reliance to be placed on internal audit and how such reliance will be supported
  - nature, extent and timing of audit procedures (for example, substantive procedures performed at year end versus control testing performed throughout the year)
  - selection of locations to be audited, assets to be verified, etc.
  - the extent of involvement of other firms
  - firm resources scheduled for executing the audit plan, including partner leadership and involvement, specialized resources (for example, tax and valuations), industry experience and expected levels of technical consultations

38. Audit committees should be prepared to consider the elements relevant to their entity in relation to the entity's risks and, in turn, advise the external auditors of any other business or financial risks that have not been addressed in the audit plan. Audit committee members should understand how the external auditors have customized the audit plan in response to the major risks facing the entity and the adequacy of resources allocated to address those risks, including the nature, extent and timing of audit procedures. The audit committee may also request the external auditors to perform audit procedures beyond those required to comply with generally accepted auditing standards (for example, to address matters of particular concern to the audit committee in overseeing the financial reporting process) and determine the relative cost of these additional procedures.
39. When assessing the reasonableness of the audit fees, audit committees may consider:
- discussing with the engagement partner the fee's reasonableness in relation to the size, complexity and risk of the engagement compared to similar engagements
  - impact of changes in the issuer's risk profile and its investment (or lack thereof) in, for example, control systems, information technology and internal audit
  - discussing with the engagement partner how the auditor ensures effectiveness and efficiency in conducting the audit (for example, through use of information technology, internal audit)
  - impact of changes in scope and/or inefficiencies such as delays in management's delivery of audit support and the existence of multiple versions of key documents
40. Audit committees should review the proposed audit fee in conjunction with the audit plan with an appropriate focus on audit quality. In particular, they should assess whether the fee will adequately support the audit plan's full execution. In doing so, it may be helpful for audit committees to discuss with management the key risks facing the entity and changes to the business that may affect the audit fee and plan. Nevertheless, audit committees remain responsible for recommending the audit fee for board approval; this decision cannot be delegated to management.

41. It can be common practice for audit committees to review the overall audit strategy and detailed audit plan together in the same meeting. AQIs to assist audit committees with both oversight activities:\*
- Experience of engagement team
    - A common way to help assess the quality of the engagement team put forward by the external auditor in the audit plan is to understand the industry experience and client knowledge of individual team members. This assessment can be measured by the number of years spent auditing the entity and/or companies in the same industry.
  - Audit hours by risk
    - The time spent by the engagement team on significant risk areas can help audit committees and management better understand the amount of effort planned in certain areas of the audit. This information can help determine whether a sufficient amount of time and resources is being allocated to addressing the major risks faced by the entity.

\*Refer to the Appendix for a list of other commonly used AQIs. For more information on AQIs, including guidance on how to select AQIs, please see the [Audit Committee Guide to Audit Quality Indicators](#)

## Monitoring the Audit Plan's Execution

42. Many mid-sized and large reporting issuers engage their external auditors to review their quarterly financial statements and report their findings to the audit committee. This gives the external auditors a scheduled opportunity to report on the progress of the annual audit. To facilitate and improve the effectiveness of these progress reports, the audit plan could allocate the timing of deliverables and key audit activities to specific time periods.
43. Many smaller reporting issuers do not engage external auditors to perform such quarterly reviews. For these issuers, the external auditors' plan often involves performing audit procedures on or after the entity's year-end, and so no audit work is performed during the year. The engagement partner and the audit committee chair should maintain regular communications so that the external auditors can respond to any significant transactions or changes in the business as they occur.

44. When an entity has engaged its external auditors to perform quarterly reviews, the audit committee's ability to effectively monitor the audit plan's execution depends on both the quality of the external auditor's quarterly progress reports and the committee's level of preparation for the quarterly meetings.
45. To help the audit committee monitor the audit plan's execution and evaluate the audit's quality, it is beneficial for its chair to have a briefing session with the external auditors before the audit committee meets. The goal of this briefing is to ensure that the chair fully understands the issues and implications of any matters the external auditors plan to raise, including their effect on audit quality, and how these matters should be addressed during the meeting.
46. In reporting to the audit committee, external auditors should communicate any significant difficulties they have encountered in executing their audit plan, which could include:
- significant management delays in performing required accounting tasks, no access to certain entity personnel or management unwillingness to supply needed information
  - areas where the audit was behind schedule or planned targets and deliverables were not met, and the reasons for such slippage
  - unexpected and extensive external auditor effort required to obtain sufficient appropriate audit evidence
  - changes in business conditions or circumstances, systems or accounting personnel not anticipated in the audit plan
  - unanticipated management restrictions
  - management's unwillingness to document and support various accounting estimates and judgments or their assessment of the entity's ability to continue as a going concern when requested by the external auditor
  - the identification of unexpected audit results, such as internal control deficiencies, and their impact on the audit
47. An important part of monitoring the audit plan's execution is assessing the communication of audit findings to management and the audit committee. This includes assessing the timeliness of both formal and informal communications and how issues raised by the external auditors are addressed. Management and the external auditors must ensure that all significant issues are communicated to the audit committee promptly and in a manner that is complete, fair and balanced. Where accounting issues are raised, the communication must fully articulate the accounting

options available, the impacts of those options and the reasons for adopting the selected option. When issues arise, management is responsible for making any necessary corrections and the audit committee is responsible for overseeing that management has done so.

48. To assist in effective communication of any problems and sensitive issues that may have arisen, the audit committee should meet in camera after separately discussing the matter with each of:
  - the external auditors
  - key management personnel
  - internal audit staff
49. The goal of these discussions should be to ensure that everyone involved shares the same understanding of the implications of the external auditors' findings and how they are to be resolved.
50. Finally, the reports from the audit committee to the board of directors on the audit plan's execution and any issues raised during the audit should be timely and sufficiently comprehensive to enable the board to understand the progression of the audit and the strategy to address any issues identified.
51. AQIs to assist audit committees in monitoring the audit plan's execution:\*

- Audit progress map with a timeline for completion of the audit mapped to key milestones within the process
  - Evaluating the timeliness of the achievement of key milestones set out in the audit process can provide useful information on the execution of the audit plan, including identifying areas that are behind schedule and the reasons for such delays. Regularly monitoring the audit progress allows the audit committee, management and the auditors to work together and take necessary action to resolve any issues identified in a timely manner.
- Management deliverables
  - Management plays a key role in achieving a quality audit. Evaluating the timeliness of agreed-upon deliverables from management to the auditor can provide useful information on the progression of the audit and identify any delays/issues that need to be addressed. This AQI can be reported by using targeted dates and the percentage of submissions from management to the external auditor or number of days late for agreement upon deliverables.

\*Refer to the Appendix for a list of other commonly used AQIs. For more information on AQIs, including guidance on how to select AQIs, please see the [Audit Committee Guide to Audit Quality Indicators](#)

## Evaluating the External Auditor's Findings

52. Professional auditing standards require external auditors to communicate specific matters to the audit committee, either annually or when a specific event occurs. Among other things, these required communications include:
- uncorrected misstatements of the financial statements, including disclosures, even when considered immaterial by management
  - the external auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures, which may include:
    - methods of accounting for significant unusual transactions and for controversial or emerging areas and sensitive accounting estimates
    - significant accounting practices that may be acceptable but that the external auditor considers may not be the most appropriate to the entity's circumstances
  - significant matters discussed with management, for example, concerns about management's consultations with other accountants on accounting or auditing matters
  - significant difficulties encountered during the audit, which may include difficulties in dealing with management
  - significant deficiencies in internal control
  - matters related to subsidiaries or investees of the issuer.
53. The primary focus of the audit committee's review of the required external auditor communications is to ensure the audit committee has enough information for recommending the approval of the financial statements to the board. The audit committee also should review these communications for indications that the external auditors have exercised professional skepticism and performed a quality audit.
54. Prompt communication and in-depth discussion with both management and the external auditors are required if any audit findings arise that could:
- require the external auditors to modify their opinion
  - add an emphasis of matter paragraph to their report
  - cause management to disclose a material deficiency in internal control in the Management Discussion and Analysis (MD&A)
  - lead the external auditors to question the issuer's ability to continue to operate as a going concern.



55. AQI to assist audit committees in evaluating the external auditor's findings:\*

- Communication with the audit committee/management
  - Effective and timely communication among the auditor, the audit committee and management related to the audit and/or wider issues of importance can help the audit committee assess the significance of any issues raised, the impact these significant issues have on the financial statements and overall audit opinion as well as indicate whether the external auditor has exercised professional skepticism. Consider assigning a rating to the quality and timeliness of each communication.

\*Refer to the Appendix for a list of other commonly used AQIs. For more information on AQIs, including guidance on how to select AQIs, please see the [Audit Committee Guide to Audit Quality Indicators](#)

# Annual Assessment of the External Auditor

56. Each year, audit committees should assess the audits performed by the external auditors. This helps audit committees fulfill their responsibility to make an informed recommendation to the board on whether or not the external auditor should be put forward in the proxy material for reappointment at the annual general meeting. It also gives the audit committee and external auditor an opportunity to identify areas for enhancing audit quality.
57. An assessment includes:
- audit quality considerations, such as:
    - auditor independence, objectivity and professional skepticism
    - quality of the engagement team provided by the external auditor
    - CPAB inspection findings
    - communication and interaction with the external auditor
  - quality of service considerations
58. When the audit committee has completed the annual assessment, it will be in a position to recommend whether the board should put forward the audit firm for reappointment as external auditor. The audit committee's assessment should be reviewed with the external auditors to help the external auditor continually improve its effectiveness and performance. The audit committee should also consider whether there are actions it should take to improve its own processes.
59. More detail about the purpose, scope, timing and process, factors to consider, conclusions, and recording and communicating the results of the annual assessment of the external auditor can be found in the annual assessment tool contained in [\*Annual Assessment of the External Auditor –Tool for Audit Committees.\*](#)

# Periodic Comprehensive Review of the External Auditor

60. There is a perception that, after an extended period of time, external auditors' relationships with clients could become too close, which may create a threat to independence that impedes the ability of the external auditor and, specifically, the engagement team members from exercising appropriate professional skepticism. To address this institutional familiarity threat, the audit committee should undertake a comprehensive review of the external auditor at least every five years. The outcome of this review is a recommendation to either retain the audit firm or put the audit out for tender. Such a review is important because:
- The onus is on the audit committee to consider any institutional familiarity threats created by audit firm tenure.
  - The review focuses on issues such as the application of professional skepticism with the aim of enhancing audit quality.
  - The audit committee's public report on the review improves the transparency of the auditor evaluation and appointment process.
61. A comprehensive review is a key element in the audit committee's oversight of the external auditor because it permits the audit committee to:
- Recommend whether to hire or retain the external auditor it considers the best for the entity.
  - Consider and recommend the timing of any change in external auditor.
  - Hone the audit committee's skill in overseeing the external auditor and enhancing audit quality.

62. The comprehensive review considers observations from the most recent audit as well as observations and trends from all other audits within the comprehensive review period. The results of prior-years' annual assessments are an important source of information in conducting a comprehensive review. The comprehensive review is deeper and broader than an annual assessment. For example, the annual assessment focuses on the engagement team, the engagement partner, their independence and objectivity and the annual quality of audit work performed; the comprehensive review focuses on the audit firm, its independence and the application of professional skepticism. The passage of time allows the audit committee to identify issues that may not be readily apparent on an annual basis, for example:
- the impact of the tenure of the audit firm on audit quality
  - trends in the audit firm's performance and expertise in a particular industry
  - incidences of independence threats and the effectiveness of safeguards to mitigate those threats
  - the responsiveness of the audit firm to changes in the entity's business and suggestions for improvement from regulators, the audit committee and/or management
  - the consistency and rigour of the professional skepticism applied by the external auditor, for example, when challenging management's significant accounting judgments
  - the quality of the engagement team and its communications
63. A comprehensive review includes reviewing and evaluating:
- significant observations and trends identified in the results of the audit committee's annual assessments
  - safeguards against institutional independence familiarity threats
  - CPAB inspection findings since the previous comprehensive review and how the audit firm has responded to these findings.
64. When the audit committee has completed the comprehensive review process, it will be in a position to recommend to the board whether to retain the current external auditor or put the audit out for tender. The process should also help identify areas for improvement both for the audit firm and the audit committee. Public disclosure by the audit committee informs shareholders that the audit committee conducted a comprehensive review of the external auditor in arriving at its recommendation to the board.

65. More detail about the purpose, scope, timing and process, factors to consider, conclusions, and recording and communicating the results of the comprehensive review of the external auditor can be found in the comprehensive review tool contained in [\*Periodic Comprehensive Review of the External Auditor—Tool for Audit Committees.\*](#)

# Acronyms Used in This Guidance

<b>AQI</b>	Audit Quality Indicator
<b>CEO</b>	Chief Executive Officer
<b>CFO</b>	Chief Financial Officer
<b>CPAB</b>	Canadian Public Accountability Board
<b>CPA Canada</b>	Chartered Professional Accountants of Canada
<b>EAQ</b>	Enhancing Audit Quality
<b>EQCR</b>	Engagement Quality Control Reviewer
<b>IAASB</b>	International Auditing and Assurance Standards Board
<b>ICD</b>	Institute of Corporate Directors
<b>MD&amp;A</b>	Management Discussion and Analysis
<b>NI</b>	National Instrument

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## 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
Audit Execution Indicators	<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

Type	Indicator	Example Definitions
Management Indicators	management deliverables	success in maintaining agreed-upon deliverables schedule from management to the auditor
	remediation of control deficiencies	efficiency of remediating control deficiencies
	reliance on controls	planned / unplanned reliance on internal controls
Firm Level Indicators	results of inspections	results of internal and/or external inspections specific to the engagement and/or to the audit firm generally (i.e., CPAB inspection findings)
	independence	results of independence findings specific to the engagement and/or to the audit firm generally
	reputation	reputation based upon news reports
	tone at the top	tone at the top determined by audit firm people-survey results
Client Service Indicators	communication with audit committee and/or management	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)
	sharing of insights	number and quality of insights gained and shared with management and the audit committee



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