



Assessing external audit quality

A suggested approach for evaluating the quality of external auditors and the external audit process

The purpose of this document is to provide a set of questions to help evaluate the quality of the external audit process, the performance of external auditors and their independence. It will be of most use to boards and audit committees looking to assess their external auditors and the work they perform.

Quality audits are a critical component of a trusted and well-functioning capital market. They are fundamental to the integrity of financial reporting and help provide important protection for investors. Understanding the quality of the external audit is also a key role for boards. As Principle 7 of the NZX Corporate Governance Code says, “The board should ensure the quality and independence of the external audit process.”

Over the past few years, stakeholder expectations of audits have been shifting rapidly both in New Zealand and internationally. By working through these questions, boards and audit committees will be able to build a clear understanding of the quality and independence of the external audit, assisting them in managing stakeholder expectations.

To evaluate audit quality we have identified three high level key questions for boards and audit committees to answer. Having comfort with the answers will ensure stakeholder confidence in the quality of the external audit.

We have also outlined more detailed questions and supplementary factors to consider as part of a comprehensive evaluation under Appendix 1. We suggest boards and audit committees consider these questions each year after the annual audit, prior to annual shareholder meetings, so that boards have a thorough knowledge of audit quality and can address any stakeholder questions.



Key questions for evaluating external auditor quality

1. How have you ensured that you are comfortable that your auditors are independent (including the effect of familiarity and the influence of non-audit services)?
2. How have you evaluated whether your auditors have the appropriate expertise to perform your audit?
3. Has the auditor appropriately challenged management's judgements in areas involving significant estimates including disclosure?

Annual report disclosure: signalling audit independence

As part of ensuring all stakeholders understand the external audit process for individual companies, it is recommended that additional details are disclosed in annual reports. To help inform readers about audit quality it would be helpful for companies to outline the following in addition to complying with the requirements of the NZX listing rules:

- the process the audit committee follows to ensure the auditor's independence is maintained¹
- details of the rotation period required of the Lead Audit Partner
- the date when the Lead Audit Partner last rotated and how many years into the rotation period they are
- any services provided by the auditor that are performed within the capacity of their role. These are likely to be other assurance reports and agreed upon procedures, for example: solvency returns to the Reserve Bank of New Zealand, or engagements required under the Financial Markets Conduct Act
- details of safeguards that have been put in place to manage any audit independence threats.¹

Additional audit quality resources for boards

- FMA, [Audit Quality - A Directors Guide](#), November 2020
- Board of the International Organization of Securities Commissions, [IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality](#), January 2019.

1. FMA, [Disclosure of fees paid to auditors by listed issuers](#), 2015



Appendix 1:

Supporting materials for comprehensive external audit assessment

The following factors may assist boards or audit committees in undertaking a detailed evaluation of the external audit process, the performance of external auditors and their independence.

We suggest that a formal assessment is undertaken each year after the annual audit but before the Annual Shareholder Meeting.

Audit firm experience and resources

What's the firm's reputation for audit services?
And, more broadly?

What is the firm, and team's, knowledge and experience in audit, particularly relating to any sector specialism that is important?

What are the firm's resources, technical expertise, sufficiency and breadth, and how does it manage continuity of knowledge?

Is the audit team able to meet deadlines and respond to issues in a timely manner?

For group audits. How important is the firm's international network and its ability to provide quality services in each significant component of the group?

Audit partner experience, leadership and relationship management

What level of experience does the Lead Audit Partner have and what are their personal credentials?

What is the business acumen and understanding of the Lead Audit Partner e.g. did the auditor demonstrate sufficient understanding of the business and the key areas of risk related to the financial statements?²

Is the Lead Audit Partner accessible to the audit committee and senior management?

How effectively did the Lead Audit Partner lead the audit including:

- sufficient involvement by senior team members and partners²
- the clarity of the auditor's written audit plan in explaining the audit strategy, the scoping of audit testing and the anticipated risks
- the clarity of the final written reports in explaining the significant approach and conclusions in relation to these areas and independence.

2. FMA, [Audit Quality - A Directors Guide](#), November 2020



Is the relationship between the Audit Committee and the Lead Audit Partner trusting, candid and professional? Is there open dialogue on all relevant issues including:

- the potential risks that should be addressed in the audit
- how identified issues were appropriately discussed and resolved
- whether your auditor raised the big questions with you
- the choice of 'key audit matters' (KAMs) and the wording to be included in the audit opinion
- any potential modifications to the audit opinion
- consistency of audit feedback (recommendations/observations) over time?

Are Lead Audit Partner conversations with executives frank, professional, a time where views are shared freely including the willingness to express any concerns about:

- reporting processes
- internal control, and
- quality and sufficiency of finance team resources?

Accountability for quality

Has the Lead Audit Partner explained how their firm, themselves and their team are appropriately held accountable for audit quality within their firm or network?

Has the Lead Audit Partner taken actions to improve audit quality and/or address issues with the previous year's audit?

3. (Adapted from) Board of the International Organization of Securities Commissions, [IOSCO Report](#) on Good Practices for Audit Committees in Supporting Audit Quality, January 2019
4. FMA, [Disclosure of fees paid to auditors by listed issuers](#), 2015

Have any significant findings from regulatory inspections (FMA or CAANZ) and global firm reviews of the entities historical audits been shared with the Audit Committee Chair?

Independence and objectivity

Did the audit team demonstrate objectivity and appropriate scepticism, or challenge management's judgements, estimates and accounting policy choices?³

Did the auditor clearly communicate how they assessed independence threats and safeguards, and complied with independence requirements?⁴

(Independence covers the free flow of information on any services performed by the audit firm to enable the Audit Committee to monitor services.)

Partner rotation

Has the Audit Partner actively engaged with the Audit Committee on upcoming partner rotation requirements?

Has the Audit Partner provided the Committee with an opportunity to meet and approve of the proposed new Audit Partner in a timely manner?

If you have any questions about this paper or would like to know more, please get in touch.



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