



# *Jason Masters Governance*

## **BOARD AUDIT COMMITTEE**

### **REVIEW OF EXTERNAL AUDIT PROCESS, THE EXTERNAL AUDITOR AND ASSOCIATED SERVICES**

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#### **POTENTIAL DISCUSSION REVIEW POINTS DECEMBER 2012**

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*This documentation is for guidance only and should be reviewed and adapted to suite the particular needs of your company, organisation and country.*

*We accept no liability for the use of this guideline and any damage that may occur to a company irrespective if appropriate questions have or have not been included.*

*Credits: These questions have been developed based upon review of a number of resources including but not limited to the AICPA series on Audit Committee Tool Kits, "Audit Committee Annual Evaluation of the External Auditor" toolkit developed by a variety of organisations.*



## REVIEWING THE EXTERNAL AUDITOR'S ENGAGEMENT LETTER

Each year the External Auditor should provide the Board via the Board Audit Committee with an engagement letter outlining their proposed audit approach, key assumptions, timetable, terms and conditions, fees and expenses proposed to be charged. The Board Audit Committee should review this document before recommending management accepting it, and the following is a list of potential items for the Board Audit committee may review.

Board Audit Committee matters to consider when reviewing the External Auditors annual engagement letter	Notes
Areas of coverage	<ul style="list-style-type: none"> <li>• Audit of the financial report in accordance with the {Country} Accounting Standards,</li> <li>• {Industry} specific legislation and regulations;</li> <li>• Any new compliance and reporting requirements;</li> <li>• Any other requirements or special needs of the organisations.</li> </ul>
Timetable	<ul style="list-style-type: none"> <li>• Interim work if applicable</li> <li>• Interim close and role forward</li> <li>• Provision of year-end trial balances</li> <li>• Client prepared schedules</li> <li>• Timing of interim and year end field work</li> <li>• Expected delivery of draft financial statement by the organisation</li> <li>• Expected Delivery of final financial statements</li> <li>• Meetings with officers</li> <li>• Meetings with Board Audit Committee (if in existence)</li> <li>• Management letter on financial audit and other requirements and officers response</li> <li>• Auditors statement</li> <li>• Schedule of information required, format and associated time expectations</li> </ul>
Assistance	<ul style="list-style-type: none"> <li>• Does the letter outline what assistance is anticipated by</li> </ul>



Board Audit Committee matters to consider when reviewing the External Auditors annual engagement letter		Notes
	the auditor from management and others in undertaking their audit?	
Other Parties	<ul style="list-style-type: none"> <li>• Are there other parties the External Auditor will be placing reliance upon in their work (such as tax advisors, actuaries, valuers, internal audit etc)?</li> <li>• Who will they be and what is the purpose of relying on those other parties.</li> <li>• Is the External Auditor satisfied with the qualification and expertise of these organisation/person.</li> </ul>	
Changes in scope	<ul style="list-style-type: none"> <li>• Process of review and approval of any changes in scope</li> </ul>	
Materiality	<ul style="list-style-type: none"> <li>• Does the letter discuss the Auditors opinion on materiality for the purposes of the audit?</li> <li>• How will any changes in materiality be managed?</li> <li>• Is the Board Audit Committee satisfied with the level of materiality, is it reasonable for the size and risks of the organisation?</li> </ul>	
Third Party Disclosures	<ul style="list-style-type: none"> <li>• Does the letter discuss any persons or organisation that the audit will provide copies of or details of their audit work?</li> <li>• Does the letter discuss other parties who may use the audit report and the purpose of that use?</li> </ul>	
Communication, Records Management & Privacy	<ul style="list-style-type: none"> <li>• The auditors approach to the management and security of information.</li> <li>• The auditors approach to access to records and documentation of the</li> </ul>	



Board Audit Committee matters to consider when reviewing the External Auditors annual engagement letter		Notes
	<p>organisation.</p> <ul style="list-style-type: none"> <li>• The auditor's record retention policy.</li> <li>• The auditor's approach to privacy in relation to the organisation financial information and private information in relation to personnel and others.</li> <li>• The auditor's obligation to advise and seek clearance in providing information to other parties (including regulators)</li> </ul>	
Conflicts of interest	<ul style="list-style-type: none"> <li>• Has the auditor declared any actual or perceived conflicts of interest for the organisation to consider and accept?</li> </ul>	
Non Audit Services	<ul style="list-style-type: none"> <li>• Has the auditor disclosed any non-audit services provided or proposed to be provided?</li> <li>• Has the organisation considered the appropriateness of those non-audit services and the potential conflict they may create?</li> </ul>	
Fees and expenses	<ul style="list-style-type: none"> <li>• Does the engagement letter clearly outline the basis for the fees and expenses to be incurred by the organisation for the audit?</li> <li>• Does the letter indicate the payment terms and structure?</li> </ul>	
Disagreements	<ul style="list-style-type: none"> <li>• Does the letter outline how any disagreements may be handled?</li> </ul>	
Terms and Conditions	<ul style="list-style-type: none"> <li>• Are the terms and conditions reasonable and comply with the respective professional requirements</li> </ul>	
Acceptance	<ul style="list-style-type: none"> <li>• Is there a requirement for the organisation to formally accept the engagement letter?</li> </ul>	





## REVIEWING THE FINANCIAL ACCOUNTS WITH THE CFO

Prior to finalising the Financial Report, the Board Audit Committee should hold a meeting with the Chief Financial Officer (or other designated financial person), and review with them the draft Financial Report. In addition to a detailed review of all of the statements and notes and questions that may arise from that review, the Board Audit Committee may consider asking the Chief Financial Officer the following questions.

Questions from the Board Audit Committee of the Chief Financial Officer in reviewing the financial report.	Notes
Do you believe the financial report fairly present the organisation's net assets and activities in accordance with the generally accepted Accounting Standards and the guidelines set by the relevant authorities	
From your perspective in working with the external auditor, are you satisfied with the scope, nature, extent, and timing of the testing performed by the external auditor?	
Do you believe the disclosures are adequate and are understandable to the members of the organisation?  If not, what changes or additional information should be provided?	
Are you aware of any situations of management override (as it relates to financial reporting) within the organisation?	
Are you aware of any current or past fraud occurrences or any kind of fraud with the organisation?  Do you know of any situation in which fraud could occur?	
Are there any areas in which the accounting treatment is unnecessarily complex and/or unusual?	
Are there any activities at any level within the organisation that you consider to be a significant violation of laws, regulations, contracts or grants, or significant departures from the Accounting Standards?	
Have you encountered any situation in which the organisation complied with legal minimums of behaviours, yet failed to go the	



Questions from the Board Audit Committee of the Chief Financial Officer in reviewing the financial report.	Notes
extra mile to demonstrate its commitment to the highest ethical standards?	
Have there been or are there any activities within the organisation that you are uncomfortable with or consider unusual that warrants further investigation?	
Has there been the creation of any new subsidiary companies, associated companies or joint venture companies (including associations and unincorporated entities) in the year relating to the financial report?  Have these entities been incorporated into the financial reports, and if not, what is the justification for their exclusion?  Who appoints the Directors of these new entities?	
Do you feel comfortable raising issues without fear of retribution?	
Are there any questions that the Board Audit Committee have not asked that should have been asked? If so what are those questions	



## REVIEWING THE FINANCIAL ACCOUNTS WITH THE EXTERNAL AUDITOR

After the External Auditor has undertaken their audit and provided their management letter and management have provided to the Board Audit Committee the final Financial Report, the Board Audit Committee may consider asking the External Auditor the following questions.

Potential Questions from the Board Audit Committee in reviewing the work of the External Auditor	Notes
<p>Explain the process your firm goes through to assure that all of your engagement personnel are independent and objective with respect to our audit.</p> <p>Particularly, with respect to non-audit services, how do these services affect the work that you do or the manner in which the engagement team or others are compensated?</p> <p>Are you aware of any anticipated event that couple possibly impair the independence, in fact or in appearance, of the firm and any member of the engagement team?</p>	
<p>Have there been any areas where the Australian Accounting Standards or any other financial reporting standards (eg from regulators or other appropriate bodies) that have not been followed?</p>	
<p>Are the financial records (including primary records, journals, supporting information etc) of the organisation recorded and maintained in a manner sufficient to meet the legislative and regulations for financial record keeping and for you to undertake your external audit?</p>	
<p>Please confirm the reliance you have place on any other external auditors, advisors, third parties to undertake your external audit. Have you been satisfied with their qualifications, provision of services and communication with your firm?</p>	
<p>Have you had reasonable time and free access to all records and documentation to undertake your audit?</p>	



Potential Questions from the Board Audit Committee in reviewing the work of the External Auditor	Notes
<p>Did you need to issues a formal request to provide documentation or records and were these produced to your satisfaction?</p> <p>Were there any defects, internal control weaknesses or irregularities on the financial reports that has not been reported in your management letter on the audit?</p> <p>Has there has been any hindrance or obstruction by any officer, employee or member in relation to you and your role and activities as auditor?</p> <p>Are you satisfied with the response of management to any defects, internal control weaknesses or irregularities?</p> <p>Have management processed any financial adjustments you require as a result of your audit in financial reports?</p>	
<p>Has management, legal counsel, or others made you aware of anything that could remotely be considered a significant violation of laws, regulations, contracts or grants, or signification departures from the Accounting Standards or legislation/ regulations/ guidelines?</p> <p>Are you aware of any compliance and ethical events within the agency that you would consider to be material?</p>	
<p>Are there any areas of the financial statements, including and most importantly, the notes, in which you believe we could be more explicit or transparent, or provide more clarity to help our members better understand our financial reports?</p>	
<p>Have you expressed any concerns or comments to management with respect to how our presentation, including the notes or Management’s discussions and analysis</p>	



Potential Questions from the Board Audit Committee in reviewing the work of the External Auditor	Notes
could be improved in our financial reports?	
<p>Which accounting policies or significant accounting transactions do you think a member would have trouble understanding based on our disclosures?</p> <p>What additional information could (should) we provide?</p>	
<p>Based on your auditing procedures, do you have any concerns as to whether management may be attempting to commit management override?</p> <p>Have you noticed any biases as a result of your audit test with respect to accounting estimates made by management?</p>	
<p>What have been the material areas of estimations/judgments in the organisation's financial report? Having reviewed the financial report, are you satisfied with the appropriateness of the estimations/judgments?</p>	
<p>In which area have you and management disagreed and what was the resolution of those matters? (Consider this question in camera session)</p>	
<p>Has there been the creation of any new subsidiary companies, associated companies or joint venture companies (including associations and unincorporated entities) in the year relating to the organisation that this financial report relates to?</p> <p>Have these entities been incorporated into the financial reports, and if not, what is the justification for their exclusion?</p> <p>Have these new entities been created in such a manner so as to comply with the required legislation and regulations?</p> <p>As the External Auditor, have you undertaken the external audit of these new entities? If not, who has undertaken the external audit</p>	



Potential Questions from the Board Audit Committee in reviewing the work of the External Auditor	Notes
of those entities and what information have you relied upon to form your opinion in relation to the organisation?	
Has your firm been engaged to provide any services beside the external audit of which the Board Audit Committee of the organisation is not already aware?	
Are there any ideas that you have discussed with management for improving the internal control systems within the organisation over financial reporting that has not been included in your management letter?	
Are there any significant/material situations/matters in which you believe management has attempted to circumvent the spirit of the financial accounting standards and guidelines, but has yet complied with them?	
Are there any significant matters going on within the organisation that you are uncomfortable with or consider unusual that would warrant further investigation? (Consider this question in camera session)	
Have the External Auditors walk the Board Audit Committee through the financial accounts and provide commentary on their work (eg analysis of current v non current assets and liabilities, key notes etc)	
Are there any other questions that the Board Audit Committee have not asked that should have been asked? If so what are those questions.  Is there any other information that wish to share with Board Audit Committee?	



## REVIEWING THE PERFORMANCE OF THE EXTERNAL AUDITOR

The Board Audit Committee should review on an annual basis, after the finalisation of the annual accounts the performance of the External Auditor.

Possible questions are:

Questions for the Board Audit Committee in Reviewing the work of the External Auditor	Notes
Did the external auditor meet with the Board Audit Committee or its delegates when requested?	
Did the key members of the External Auditor team work on the external audit as agreed in the engagement letter?	
Were there any issues that the External Auditor should have or did consult with their professional technical experts in a timely manner?	
When has the External Auditor last been subject to a peer or regulator review and what if any outcomes were there?	
How has the External Auditor demonstrated it has maintained industry knowledge and expertise?	
Were appropriate specialists (such as IT Audit) used on the external audit?	
Where appropriate, (depending on the Internal Audit strategic plan) did the External Auditor adequately consider the work of Internal Audit?	
Did the External Auditor consider issues such as the “tone at the top” or the organisation,” antifraud and corruption programs and controls in place in the organisation?	
Did the External Auditor inform the Board Audit Committee of any risks of which it was not previously aware?	
If not, is the Board Audit Committee aware of any risks not discussed with the External Auditor that may impact on the financial reporting?	
Did the External Auditor communicate issues freely with the Board Audit Committee, or did the auditor seem protective of management?	



Questions for the Board Audit Committee in Reviewing the work of the External Auditor	Notes
Does it appear that management exercises undue influence on the External Auditor?	
Does it appear that the external auditor is reluctant or hesitant to raise issues that would reflect negatively on management or the organisation in general?	
Reviewing all the External Audit-related and non-audit services conducted by the External Auditor in the prior year, is the Board Audit Committee satisfied that the External Auditor remained independent and objective both in fact and appearance?	
Did the External Auditor provide constructive observations, implications, and recommendations in areas needing improvement, particularly with respect to the organisation's internal control system over financial reporting?	
How constructive are the key issues communicated in any issued management letter and other disclosures on audit findings and recommendations?	
Did the External Auditor discuss emerging risks and issues relating to the industry as they affect the organisation's annual accounts?	
Are we satisfied that the fee payable to the External Auditor is fair and reasonable, allowing a reasonable return?	
Are we satisfied that the External Auditor is not overly depended on our external audit which may indirectly lead to a reduction in their independence and skeptical thinking in undertaking the external audit.	