About the Mauritius Audit Committee Forum

Recognising the importance of Audit Committees as part of good Corporate Governance, the Mauritius Institute of Directors (MIoD) and KPMG have set up the Mauritius Audit Committee Forum (the Forum) in order to help Audit Committees in Mauritius, in both the public and the private sectors, improve their effectiveness.

The purpose of the Forum is to serve Audit Committee members and help them adapt to their changing role. Historically, Audit Committees have largely been left on their own to keep pace with rapidly changing information related to governance, risk management, audit issues, accounting, financial reporting, current issues, future changes and international developments. The Forum provides guidance for Audit Committees based on the latest legislative and regulatory requirements. It also highlights best practice guidance to enable Audit Committee members to carry out their responsibilities effectively. To this end, it provides a valuable source of information to Audit Committee members and acts as a resource to which they can turn for information or to share knowledge.

The Forum’s primary objective is to communicate with Audit Committee members and enhance their awareness and ability to implement effective Audit Committee processes.

Position Paper series

The Position Paper series, produced periodically by the Mauritius Audit Committee Forum, aims to provide Board directors and specifically Audit Committee members with basic best practice guidance notes in running an effective Audit Committee.

Position Paper 1 was issued in July 2014 and sets out the essential requirements that should be complied with by every Audit Committee in accordance with the National Code of Corporate Governance. Essentially, the Position Paper series provide best practices to elaborate on these mandatory requirements. The current Position Paper 2 sets out specifically how the Audit Committee can accomplish its duties through a collaborative relationship with two of the Assurance Providers, notably Internal and External Auditors.

Current Members of the Forum

Collectively, the Forum is made up of members drawn from diverse professional backgrounds with significant experience in both the private and the public sectors.

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<tr>
<th>Name</th>
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Contents

Introduction 2
The three lines of defense 3
Internal Audit 4
External Audit 7

Appendix

1. Key questions for review of effectiveness and efficiency of Internal Audit 11
2. Key questions for review of effectiveness and efficiency of External Audit 12
Introduction

Audit Committee members are more than ever focused on enhancing both the effectiveness and efficiency of their Audit Committees.

A central theme is the interaction of the Audit Committee with the major assurance providers, being the External Auditor, the Internal Auditor, Management and Other Assurance Providers.

The objective of the current paper, Position Paper 2, is to discuss how best to enhance an effective oversight process by strengthening and optimising the relationship between the Audit Committee and the Internal and External Audit functions of the enterprise.

For this purpose, the Audit Committee should understand the precise and unique role of each assurance provider in the financial reporting process and must hold each participant accountable. In the light of this understanding, the Audit Committee should ensure that there is effective co-operation among the various assurance providers.

Management

To initiate the appropriate tone from executive management, an entity should put a premium on integrity, accuracy and transparency in reporting to stakeholders. The Audit Committee should constantly assess whether executive management is demonstrating the appropriate tone of communication and whether this is filtering down to the rest of the entity. The Audit Committee should guarantee that the entity’s Code of Conduct and Ethics is complied with and upheld by top management.

Probing questions about the entity’s financial reporting process must be asked by the Audit Committee to gain deeper understanding and management assertions in this respect must be challenged, in case of doubt.

Internal Auditor

The Audit Committee needs to ensure that the Internal Audit function is competent and independent and has the adequate resources, standing and authority to enable it to perform its functions comprehensively and effectively. The Audit Committee must review and approve the Internal Audit Charter and Plan, so as to ensure the coverage of all material risk areas and to verify whether the business processes are acceptable. Internal Audit is administratively answerable to Management, but should report directly to the Audit Committee and its Chairman.

External Auditor

The External Auditor is another important linchpin towards ensuring that the entity’s financial reporting is comprehensive, correct, clear and compliant with current financial reporting standards. The Audit Committee should work collaboratively with and provide support to the External Auditor. Key to External Audit effectiveness is its independence. The Audit Committee should take steps to ensure the independence of the External Auditor in accordance with the requirements of the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants.

Other Assurance Providers

The Audit Committee may call upon other assurance providers in order to obtain necessary guidance and interpretation of facts to fulfill its duties comprehensively. They include, but are not restricted to, the Risk Committee Chairman, Company Secretary, Legal Advisor, Actuary or Compliance Officer, depending on industry-specific or circumstantial business requirements. As in the cases of the Internal and External Auditors, the Audit Committee should consider any additional information obtained from assurance providers in the finalisation of Financial Statements of the entity. It is therefore highly important for the Audit Committee to understand the precise and unique role of each assurance provider in the financial reporting process and it must accordingly have recourse to and hold each assurance provider accountable for its specific responsibility towards the entity.

The focus of this paper is to provide insights on the interaction of the Audit Committee with the Internal Auditor and External Auditor.

Assurance Providers

Assurance is about providing accurate and current information to stakeholders relative to the efficiency and effectiveness of the company’s policies and operations, and the status of its compliance with the statutory obligations. Assurance providers are often tasked with providing assurance in their respective fields of competence and in accordance with an agreed terms of reference.
The Three Lines of Defense

The challenges arising from economic situations and legislations have increased the pressure for companies to adopt a robust governance framework and for the need to sustain a good relationship between assurance providers and the Audit Committee.

How can companies strengthen these relationships?

The Three Lines of Defense model can be used as the primary means to demonstrate and structure roles, responsibilities and accountabilities for decision making, risk and control to achieve effective governance, risk management and assurance.

Senior management and governing bodies collectively have responsibility and accountability for setting an entity’s objectives, defining strategies to achieve them, and establishing governance structures and processes to best manage the risks in trying to attain these objectives.

Often they are considered as additional lines of defense, providing assurance to the entity’s owners, governing bodies and senior management.

The Three Lines of Defense in the risk management model are:

1. management control;
2. the various risk control and compliance oversight functions established by management; and
3. independent assurance provided by Internal Audit.

Each of these three “lines” plays a distinct role within the entity’s wider governance framework.

External Auditors and Regulatory Bodies operate the entity’s structure, but can still play an important role in the entity’s overall governance and control structure.

Source: Institute of Internal Auditors
Internal Audit

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an entity’s operations. It helps an entity accomplish its objectives by bringing a continuing, systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The Internal Audit function

The National Code of Corporate Governance requires that companies should have an effective Internal Audit function that has the respect, confidence and co-operation of both the Board and Management. The Internal Audit function should be in conformity with standards established by The Institute of Internal Auditors (IIA).

Where the Board, at its discretion, decides not to establish an Internal Audit function, full reasons must be disclosed in the company’s annual report, with an explanation as to how assurance of effective internal controls, processes and systems will be obtained in the absence of an explicit Internal Audit function. The Board of a company which does not have an Internal Audit function should review, at least annually, the need for one.

Relationship with the Audit Committee

An effective relationship between the Audit Committee and the Internal Auditor is fundamental to the success of the Internal Audit function. It has become increasingly important for Audit Committees to assess whether the Internal Auditors are monitoring critical controls and identifying and addressing emerging risks.

The specific expectations for Internal Audit functions vary from one organisation to another, but should nevertheless include the following elements:

- objectively monitor and report on the health of financial, operational, and compliance controls;
- provide insight into the effectiveness of risk management;
- offer guidance regarding effective governance;
- become a catalyst for positive change in processes and controls;
- deliver value to the Audit Committee, Executives and Management in the areas of controls, risk management and governance to assist in the Audit Committee’s assessment of the efficacy of programs and procedures;
- coordinate activities and share perspectives with the External Auditor.

The National Code of Corporate Governance requires that companies should have an effective Internal Audit function that has the respect, confidence and co-operation of both the Board and Management.
Role and scope of the Internal Audit
Internal Audit’s role is to assist the Audit Committee in discharging its governance responsibilities by providing:

- a review of the ‘tone at the top’ of the entity;
- an objective evaluation of the risk and internal control framework;
- systematic analysis of business processes and associated controls;
- reviews of the existence and value of assets and liabilities;
- specific information on frauds and irregularities, if any;
- ad hoc reviews of other areas where there is a concern or an unacceptable level of risk being taken;
- reviews of the compliance framework and specific compliance issues, including regulatory compliance;
- reviews of operational and financial performance;
- recommendations for more efficient and effective use of resources;
- assessments of the accomplishment of corporate goals and objectives; and
- feedback on adherence to the entity’s values and code of conduct and/or code of ethics.

Reporting Lines
An Internal Audit function, designed and deployed effectively, can have a positive impact on the control environment of an entity and on the effective design and operation of internal controls. As an important aspect of its mandate, Internal Audit can provide the Audit Committee with a means of monitoring if the controls management has put in place are reliable, functioning properly and sufficient to address the risks in the financial reporting process. Accordingly, Audit Committees should regularly review the need for, and scope of, the Internal Audit function.

A significant challenge for Internal Auditors is the fact that while they report to the Audit Committee, they interact on a daily basis with management, are employed by management and yet are expected to review management’s conduct. Despite this close proximity with management, Internal audit should acknowledge the Audit Committee and not management as their primary client.

It is important that the Internal Audit function retains a safe degree of independence from management so that it may carry out its function impartially.

The decision as to the appropriate sourcing of this function by the entity will usually be driven by the availability of appropriate skills internally (such as Information Technology skills) and the breadth and depth of ability and skills to cover the entity’s business operations adequately and effectively.

The Internal Audit Plan
The proposed depth and breadth of the Internal Audit Plan, and particularly any restrictions placed on the scope of the Plan, needs to be fully discussed and debated by the Audit Committee, at the start of the reporting year before it is approved.

This Plan should be the guide by which Internal Audit assists the Audit Committee, and ultimately the board, in assessing the adequacy of the risk and control framework.

Once the Internal Audit Plan has been implemented, the Audit Committee should review the Internal Audit reports and assess the adequacy of management’s response to any weakness in the risk and control environment or any other irregularities.

Internal Audit should follow up on these issues and report back to the Audit Committee on its findings. Internal Audit should consider utilising an internal control issues register to facilitate this process.

The scope of the Internal Audit Plan would depend from entity to entity but could cover a period of up to three years. While the timing of the individual projects in the Plan may be flexible, all amendments and deferrals need to be authorised by the Audit Committee, taking into consideration the criticality of risks involved.

The Audit Committee needs also to ascertain whether the Internal Audit Plan covers emerging areas of concern such as adherence to organisational values and code of conduct. Management needs to be forthcoming in identifying any areas of potential weakness, which should be included in the Internal Audit Plan to assist in developing a culture of openness.

For other authoritative guidance materials provided by The IIA, please visit the website at www.globaliia.org/standards-guidance

Special Assignment
Audit Committee members need to be aware of the need to undertake special investigative reviews from time to time, in addition to the agreed Internal Audit Plan, such as in the area of fraud or conflicts of interest. However, it is essential that the Internal Audit Plan be completed over the Plan period and not be side-tracked by ad-hoc tasks requested by Management. The Audit Committee needs to be satisfied that all identified risks are being addressed.
Communication

The administrative reporting lines of Internal Audit, although important, are not nearly as critical as a direct reporting line between Audit Committee and Internal Audit. Audit Committees that have established clear reporting lines for Internal Audit are in the best position to employ them appropriately as a strong component of the financial reporting process.

It should be clear that the Internal Auditor must have direct access to the Chairman of the Audit Committee and vice versa, as required. In this way, it is possible for Internal Audit to retain a fair degree of independence from Management and the Chief Executive Officer.

In addition, the Audit Committee as a whole should have proper mechanisms in place to ensure that there is a frank and confidential exchange of information with Internal Audit. One such process may involve the standard practice for the Audit Committee to meet alone with Internal Audit, without management or External Audit, for part of each Audit Committee meeting.

The Audit Committee should receive regular written reports from Internal Audit on the results of its work, including management’s response to Internal Audit recommendations. Furthermore, these Internal Audit reports should be available to the External Auditor.

Appropriate Resourcing

Determining whether there are sufficient resources and skills to undertake an Internal Audit adequately is a critical responsibility of the Audit Committee. The Audit Committee needs to be satisfied that the Internal Audit team comprise people not only with traditional accounting skills but also people with business skills and industry and technology based expertise. If these skills are not available within the Internal Audit function, the Audit Committee may consider contracting specialists to perform these functions on an ad-hoc basis.

While the Internal Auditor is under the administrative responsibility of Management, given the importance of Internal Audit to successful Audit Committee outcomes, the prior consent of the Audit Committee should be obtained when reviewing and confirming the appointment, replacement, re-assignment or dismissal of the Head of Internal Audit.

The Audit Committee should also be involved in any matters associated with the performance evaluation and remuneration of the Head of Internal Audit, if the function is undertaken in-house, or the terms of engagement including the scope of Internal Audit where the function is either outsourced or co-sourced. Members of the Internal Audit function must remain up to date with changes in the accounting and Internal Audit profession. This should be achieved through in-house update sessions or training workshops presented by the various professional bodies on a regular basis.

The Audit Committee’s expectations from Internal Audit, including its performance criteria, should be clearly communicated in writing.

Evaluating Internal Audit effectiveness

In evaluating the effectiveness of Internal Audit, the Audit Committee needs to assess the effectiveness of Internal Audit against agreed performance criteria, including:

- compliance by Internal Audit – be it in-house, outsourced or co-sourced – with its agreed charter or plan/scope and level of performance;
- the overall comprehensiveness of the Internal Audit Plan and its relationship with the strategic objectives of the business;
- delivery of timely Internal Audit services in accordance with the Plan; and
- the competency of Internal Audit staff and adequacy of resources to achieve the scope as outlined in the Plan. This may require outsourcing certain specialist skills not available in the Internal Audit function.

The Audit Committee, should, on an annual basis, request a review of Internal Audit performance from various sources including management and the External Auditor.

Appendix 1 provides a recommended checklist for evaluation of the Internal Audit function.
External Audit

An External Audit is an independent examination of the Financial Statements prepared by the organisation. It is usually conducted for statutory purposes (Companies Act or other legislation) or regulatory purposes. An audit results in an audit opinion about whether the Financial Statements give a ‘true and fair’ view of the:

- state of affairs of the organisation; and
- operations for the period.

Appointment

The Mauritius Companies Act requires the appointment of an External Auditor at each annual meeting of the company to audit the Financial Statements of the company. An annual audit is an essential part of the checks and balances required, and is one of the cornerstones of corporate governance.

Audit Committees are taking greater responsibilities, including an enhancement of the responsibilities associated with recommending the appointment of External Auditor and approving non-audit services.

The Audit Committee should submit a recommendation to the Board for consideration and acceptance by shareholders for the re-appointment and, if necessary, the removal of the External Auditor.

Interaction with Audit Committees

Audit Committees should keep the External Auditor apprised of issues which “keep them awake at night.” Similarly, the External Auditor has a responsibility to raise with the Audit Committee any concerns and any instances of non-compliance or violations of laws or regulations.

To have an effective relationship between the Audit Committee and External Audit, there should be a mechanism in place to facilitate an open and frank exchange of information between committee members and External Audit throughout the year. Audit Committee members should be in a position to be able to openly discuss matters of interest in a sensible manner with the External Auditor in any areas covered by the Audit Committee’s functions.
Matters to be communicated

Pursuant to the auditing standards, the External Auditor is required to communicate on the following to the Audit Committee:

• acknowledgement of terms of the audit — the Audit Committee has to agree to the terms of the audit which shall include amongst others the scope of the audit, timing of the engagement, the fees, the engagement team;

• audit strategy — the External Auditor will be required to provide more detail about the audit strategy, including the timing and significant risks identified by the External Auditor and any significant changes to the planned strategy or significant risks identified in the course of the audit and the reasons for changes;

• obtaining information relevant to the audit — in addition to current inquiries regarding fraud risks, the External Auditor will need to inquire with Audit Committee members whether they are aware of matters relevant to the audit, including violations or possible violations of laws or regulations; similarly, the External Auditor should concurrently with its auditing activity inform the Audit Committee of any such information having come to its notice;

• accounting policies and practices, estimates, significant unusual transactions and the External Auditor’s evaluation of the company’s financial reporting;

• difficult or contentious issues that might impact the External Auditor’s audit opinion;

• going concern — the External Auditor will be required to communicate conditions and events that indicate a substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time. If the External Auditor concludes that doubt is alleviated, the External Auditor will be required to communicate the basis for that conclusion, including Management’s plans that led to the External Auditor’s conclusion. If the doubt is not mitigated, the External Auditor will be required to describe the effect of the uncertainty on the Financial Statements and the auditor’s report;

• Internal Audit work – the External Auditor will be required to evaluate the Internal Audit Function, and to determine the nature and extent of work of the Internal Audit Function that can be used for External Audit;

• corrected and uncorrected audit misstatements and their impact on the Financial Statements.

The Audit Committee should also obtain from External Audit the results of their audit of the Financial Statements. The Audit Committee should also be briefed periodically on the results of any performance audits or assurance reviews undertaken.

In the current environment, many Audit Committees are considering how they should discharge their responsibilities in relation to the effectiveness and efficiency of the External Audit arrangements.
Meetings
It should be standard practice for the External Auditor to meet annually with the Audit Committee’s members, typically at the audit planning stage and at the end of the audit prior to sign-off of the Financial Statements.

It is further recommended that the Audit Committee meets with the External Audit Partner separately in the absence of management at least once a year. Having a private session with External Audit representatives provides an important opportunity for the Audit Committee to raise issues, ask questions and seek feedback from External Audit without being influenced by Internal Audit or Management present.

Evaluation of External Auditor
The Audit Committee plays a key role in keeping under review the scope and results of the External Audit, its cost effectiveness and the independence and objectivity of the auditors. Where the auditors also supply a substantial volume of non-audit services to the company, the Audit Committee should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money. In extreme cases, Audit Committees have gone as far as banning non-audit services by auditors to remove any risk of impairing the auditor’s independence.

In the current environment, many Audit Committees are considering how they should discharge their responsibilities in relation to the effectiveness and efficiency of the External Audit arrangements. Tendering the audit is by no means the only available option under this responsibility – Audit Committees are capable of evaluating the performance of their independent auditors and holding them accountable for the performance of their professional duties.

A review of the audit process, the effectiveness and performance of the audit team, and the output, quality and cost effectiveness of the audit, is a valid alternative to the tender approach. Not only would such a review help optimise the performance of auditors, it would also encourage good communication between the auditors and the Audit Committee.

Such a review should evaluate the relationship between the auditors and executive management and ensure that an appropriate balance exists. The relationship should not be so close as to put at risk the auditors’ independence and objectivity. Yet at the same time, it should be such that management and auditors can work together in an environment of constructive challenge.

Appendix 2 provides a recommended checklist for evaluation of External Auditor.
Appendices
Appendix 1

Key questions for review of effectiveness and efficiency of Internal Audit

This Appendix suggests a checklist for an Audit Committee to carry out a formal review of the effectiveness and efficiency of the Internal Audit function. Such questions provide the Audit Committee with a disciplined approach to keeping the Internal Audit performance under review, and to ensuring that the Internal Audit function remain abreast of changes affecting the entity and its business environment.

Quality processes
- Is Internal Audit responsive to the needs of today's environment?
- Which model of Internal Audit suits the company best: in-house, co-sourcing or out-sourcing?
- Have sufficient resources been allocated for an effective Internal Audit function?
- Is Internal Audit cognizant of the constitution of the company, applicable laws and regulations and leading industry practices?
- Do Internal Audit personnel proactively consult on internal controls and risk management?
- Is the process of Internal Audit designed to identify whether the organisation is controlling those areas that are important to control, and not just those that are easy to control?
- Is Internal Audit satisfied with the implementation of action plans agreed for prior year recommendations?
- Has Management reached a supportable conclusion regarding whether Internal Audit complies with IIA's standards?

Performance evaluation
- Have the Audit Committee and Senior Management reconciled their expectations for Internal Audit? Have they agreed on how to measure performance?

Interaction
- How does Internal Audit relate to, and interact with, other risk management-related functions, such as legal, security, environmental health and safety, loss prevention, quality and risk management, compliance and credit risk?
- Are there duplications of effort or gaps between Internal Audit and these groups?

Reliance on work by External Auditor
- Is Internal Audit viewed as objective and effective by the External Auditor?
- How productively does Internal Audit interact with External Audit?
- Is the work of the Internal Audit being relied on by the External Audit?

Governance and independence
- Has the conduct of any special assignments by the Internal Auditor impacted on implementation of the Internal Audit Plan and the objectivity of the Internal Auditor?
Appendix 2

Key questions for review of effectiveness and efficiency of External Audit Firm

This Appendix suggests a checklist framework for an Audit Committee to carry out a formal review of the effectiveness and efficiency of their External Auditor. Such a review provides the Audit Committee with a disciplined approach to keeping the External Auditor’s performance under review. It will also help to ensure that the External Auditor remain alert to the company’s needs.

Credentials of External Audit Firm

- What is the reputation of the External Audit firm?
- Are there recent or current litigation cases against the External Audit firm?
- What is the reputation and presence of the External Audit firm in its industry?
- Does the External Audit firm have the experience, size, resources and geographical coverage required to audit the company?
- Has the External Audit Firm and the Audit Partner been reviewed by the Financial Reporting Council?
- Has the External Audit Firm and the Audit Partner been subject to any disciplinary actions by the Financial Reporting Council?

Quality processes

- What are the quality control processes in the External Audit firm?
- Factors to be considered include the level and nature of review procedures, the approach to audit judgements and issues, independent quality control reviews and the External Audit firms approach to risks.
- How are key audit individuals at the External Audit firm compensated and evaluated, and do these compensation and evaluation schemes run the risk of impairing the External Auditor’s independence?
- What is the External Audit firm’s process for internal review of accounting judgements, including an understanding of the key issues?
- What relevant specialists does the External Audit firm employ and how are these linked to the audit process?

Audit team

- Do the individuals assigned to the External Audit team have the requisite expertise, including industry knowledge, to effectively audit the company?
- Are sufficient quality resources being allocated by the External Audit firm?
- What is the scope of the engagement partner’s/ other senior personnel’s involvement in the audit process and is it sufficient?
- Does the External Audit firm have adequate key team member succession plans in place which meet the relevant audit partner rotation requirements and facilitate the maintenance of objectivity?
Audit scope
- Is the External Audit scope adequate to address all of the financial reporting risks facing the company?
- Factors to be considered include the geographical coverage, the allocated resources, the level of audit testing and nature of the audit reports issued at each location.
- Does the External Audit firm agree the audit scope and plan with the Audit Committee before the audit commences?
- Is specialist input to the audit in areas such as taxation, pensions, valuation regulatory and environment at an appropriate level?
- Are all key operations covered by the External Audit firm?
- How are audits of overseas or remote locations controlled and is audit effectiveness regarded as consistent internationally?
- Are the reporting processes for subsidiary audit teams effective?
- What is the External Audit firm’s approach to seeking and assessing management?
- Does the External Audit team have an effective working relationship with Internal Audit?

Audit fee
- Is the External Audit fee reasonable given the scope of the External Audit, and how does the audit fee compare with other similarly-sized companies in this industry?
- How are differences between actual and estimated fees handled?

Audit communications
- Does the External Audit firm discuss with the Audit Committee about significant issues and new developments regarding risk management, corporate governance, financial accounting and related risks and controls on a timely basis?
- Does the External Audit firm discuss the critical accounting policies and whether the accounting treatment is conservative or aggressive?
- Does the External Audit firm meet freely and regularly with the Audit Committee, in the absence of management, to discuss issues arising from the audit or any other matters they may wish to raise?
- Does the External Audit firm resolve accounting issues in a timely manner?
- Does the External Audit firm seek feedback on the quality and effectiveness of the service being provided?

Audit governance and independence
- Is the relationship with the External Audit firm controlled by the Audit Committee or does management control the relationship?
- Does the External Audit firm have open lines of communication and reporting with the Audit Committee?
- Are unadjusted audit differences and significant weaknesses in internal controls appropriately communicated?
- Do the individuals assigned by the External Audit firm demonstrate a high degree of integrity in their dealings with the Audit Committee?
- Does the External Audit firm discuss their internal process for ensuring independence with the Audit Committee? E.g. regulatory requirements for firm and/or partner rotation
- Do management respect the External Audit firm as providers of an objective and challenging audit process?
- Is the level and nature of entertainment between the External Audit firm and management appropriate?

Non-audit services by the External Auditor
- What are the company’s policies with regards to provision of non-audit services by the External Auditor?
- Does the nature of non-audit services provide any potential to impair audit independence?

Such a review provides the Audit Committee with a disciplined approach to keeping the External Auditor’s performance under review.