

Steigerung des Nutzens der Revision durch aktives Engagement

RAB Workshop für Verwaltungsräte und Investoren

7. November 2019, Zürich

Frank Schneider, Direktor RAB, Chair IFIAR

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4. Center for Audit Quality – Assessment Tool April 2019

1. Tagesprogramm

13.30 – 14.00	Empfang und Begrüssungskaffee
14.00 – 14.30	Begrüssung, aktuelle internationale Entwicklungen Frank Schneider, Direktor RAB
14.30 – 15.15	Stärkung der internen Revision, Trends und Koordination mit der externen Revisionsstelle Natacha Theytaz, Global Head of Business Assurance & Advisory and Head of Internal Audit, Novartis
15.15 – 15.45	Pause
15.45 – 16.15	Unabhängigkeit der Revisionsstelle aus Sicht des AC Dr. Reto Sanwald, Leiter Recht und Internationales, stellvertretender Direktor RAB
16.15 – 17.00	Roundtable mit Vertretern von Verwaltungsräten und Investoren zum Thema «Steigerung des Nutzens der Revision durch aktives Engagement» Moderatorin Wanda Eriksen, Präsidentin des Verwaltungsrates der RAB
ab ca. 17.00	Apéro

1. Einleitung

- Vision der RAB: Wir setzen uns für die Relevanz und die Glaubwürdigkeit der Revision ein.
- Hauptmission der RAB: Aufsicht über Revisionsorgane von Gesellschaften des öffentlichen Interesses
- Verwaltungsräte und Investoren sind wichtige Stakeholder der Revision
- Erfahrung zeigt klar und deutlich: Involvierte Stakeholder erhöhen die Qualität der Revision

2. IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality (1)

The Role of Audit Committees and Audit Quality

- Einflussfaktoren Audit Quality:
 - Kultur und Governance im Revisionsunternehmen (inkl. Förderung einer kritischen Grundhaltung)
 - Verständnis der Geschäftsrisiken durch Revision
 - Erfahrung und Know-How des Revisionsteams
 - Begleitende und nachgelagerte Überwachung der Revisionsarbeiten
- Rolle des Audit Committee

2. IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality (2)

86 Possible Good Practices

- 13: The AC should be the key representative body with which the external auditor interacts
- 16: Audit tender to be independent from company's management
- 19: ... fees not being given undue weight in selecting an auditor
- 23: Potential auditors are not asked for their views on contentious judgement or accounting treatments
- 50: Management has produced all information, records in a timely manner

2. IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality (3)

86 Possible Good Practices (continued)

- 55: Non-audit services to be approved by Audit Committee in advance
- 65. / 77. The auditor demonstrates professional scepticism (re accounting estimates and accounting policies)
- 73. The AC meets with the auditor without management present
- 84. – 86. Finding from regulatory inspections are evaluated

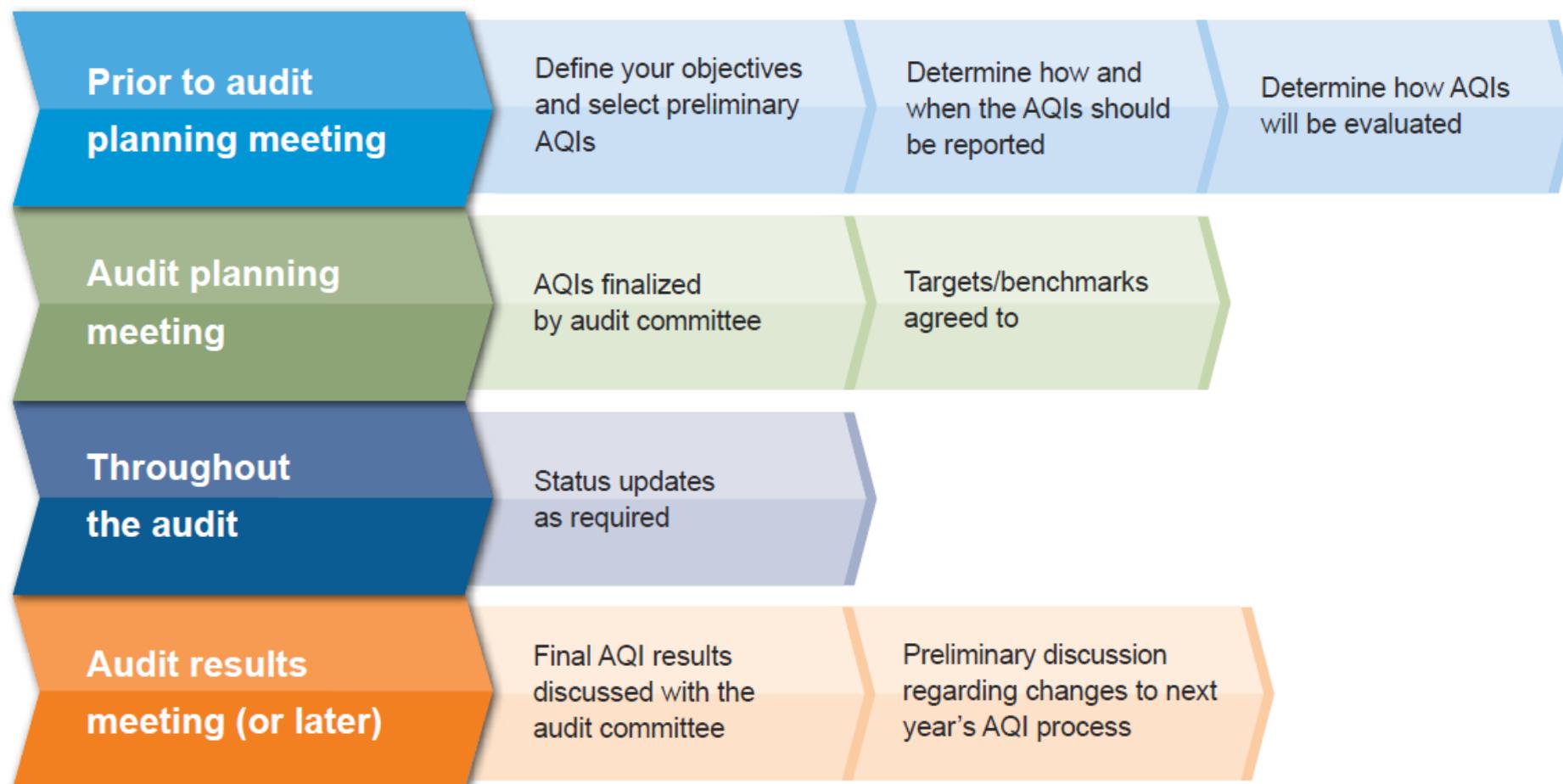
3. CPAB - Final Report on Audit Quality Indicators (1)

Projekt der Kanadischen Revisionsaufsichtsbehörde (CPAB)

- Pilot Projekt in 2016 mit 6 Kanadischen Emittenten (AC), danach auf 18 Emittenten erweitert
- Ziel: Innovation in der Messung der Revisionsqualität mittels AQIs
- Selektion von individuellen AQIs nach firmenspezifischen Gegebenheiten: Geschäftsmodell, Prüfungsrisiken etc.

3. CPAB - Final Report on Audit Quality Indicators (2)

Möglicher Prozess:



3. CPAB - Final Report on Audit Quality Indicators (3)

Beispiele (1):

Type	Indicator	Example Definitions
Engagement Team Indicators	Experience of engagement team	Delivery of agreed upon team skills (industry/ specialty/client knowledge) Years of audit experience of key members of the engagement team
	Training and professional development	Number of hours and type of professional development and technical training attended by key engagement team members
	Turnover of engagement team	Turnover rates of key engagement team members and/or level
	Partner / manager involvement	Per cent of audit hours carried out by senior engagement team members compared to the entire engagement team
	Partner workload	Information about the level of work for which key engagement partners are responsible for and the number of claims on his or her attention

1

3. CPAB - Final Report on Audit Quality Indicators (4)

Beispiele (2):

Audit Execution Indicators 2	Audit hours by risk	Time spent by the engagement team on significant risk areas
	Timing of audit execution	Audit hours by phase (planning, interim, year-end)
	Audit progress milestones	A timeline for the completion of the audit which is mapped to key milestones within the process
	Technology in the audit	Use of technology initiatives in the audit, including information about areas of use, types of tools, number of hours, etc.
	Specialist engagement	Where and how much (measured in hours) persons with “specialized skill and knowledge” are used in the audit
	Service delivery centres	Amount of audit work centralized at service centres
Management Indicators 3	Management deliverables	Achievement of timing of agreed upon deliverables from management to the auditor
	Remediation of control deficiencies	Efficiency of remediation of control deficiencies
	Reliance on controls	Planned / unplanned reliance on internal controls

3. CPAB - Final Report on Audit Quality Indicators (5)

Beispiele (3):

4 Firm Level Indicators	Results of inspections	Results of internal and/or external inspections specific to the engagement and/or to the audit firm generally
	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

5 Client Service Indicators	Communication with audit committee	Effective and timely communications between 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

4. Center for Audit Quality – External Auditor Assessment Tool 2019

Bestandteile

- Part 1: The Engagement Team
- Part 2: The Audit Firm
- Part 3: Communication and Interaction
- Part 4: Independence, Objectivity and Professional Scepticism

Vorlagen / Checklisten

Vielen Dank für Ihre Aufmerksamkeit!
Fragen?



Anhang: Mehr Informationen zur RAB

- Allgemeine Informationen, FAQs: www.rab-asr.ch
- Spezifische Fragen: info@rab-asr.ch
- Gesuch um Zulassung (elektronisch): www.rab-asr.ch
- Verfügt das Revisionsunternehmen über die richtige Zulassung?: www.rab-asr.ch → Register

**IOSCO Report on
Good Practices for Audit Committees in
Supporting Audit Quality**



OICU-IOSCO

**The Board
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

FR01/2019

JANUARY 2019

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Chapter 1 – Executive Summary

IMPORTANT NOTE: SCOPE OF THIS REPORT

This report concerns the role of audit committees of listed companies¹ in supporting and promoting external audit quality.

The features of audit committees and the role of audit committees in relation to financial reporting are only covered to the extent these are relevant to audit quality. These two areas are not the focus of this report and it is not intended to provide a comprehensive list of good practices for audit committees in these areas.

Further, this report is not intended to cover other matters such as the role of audit committees in relation to any internal audit function. Unless otherwise stated, “audit” in this report refers to external audit.

This Report provides IOSCO’s views on good practices for audit committees of listed companies in supporting external audit quality.

The quality of a company's financial report, supported by an independent external audit, is key to market confidence and informed investors, and to the effective functioning of capital markets. The audit committee has an important role in the quality of the financial report, since audit quality relates to an effective and independent audit function that is appropriately supported by the company.

While the auditor has primary responsibility for audit quality, the audit committee should promote and support audit quality and thereby contribute to greater confidence in the quality of information in the listed company’s financial reports. The good practices report can therefore assist audit committees in considering ways in which they may be able to promote and support audit quality.

Findings by audit regulators, for example, as reported by the International Forum of Independent Audit Regulators (IFIAR)² indicate a need to improve audit quality and the consistency of audit execution.

Further, the practices of audit committees within the same jurisdiction, and across jurisdictions, can vary from one listed company to the next, leading to a lack of consistency in the way audit committees carry out their responsibilities.

¹ The good practices in this report may also be relevant to other types of entities by analogy. References to listed companies and companies should be read to include their controlled entities, where appropriate.

² IFIAR Report on 2017 Survey of Inspection Findings - <https://www.ifiar.org/?wpdmdl=7970>

1.1 The Role of Audit Committees and Audit Quality

Chapter 2 of this Report gives details about the role of audit committees and audit quality. Chapter 2 also briefly summarises the role of some other key parties in the financial reporting cycle.

1.2 Good Practices

Chapter 3 of this Report outlines good practices regarding the features an audit committee should have to be more effective in promoting and supporting audit quality. These features include the qualifications and experience of audit committee members, their level of knowledge in the field of financial reporting and audit, and whether they have questioning minds and appropriately challenge management and auditors. These features also include whether the audit committee has adequate capacity and resources.

Chapter 3 outlines the following good practices for audit committees in promoting and supporting audit quality:

- *Recommending the appointment of an auditor* (Section 3.3): audit committees should develop a recommendation on the selection of auditors independently of management with selection criteria set up front and tenderers assessed against those criteria. The focus should be on audit quality and not fee reduction. Opinion shopping should be avoided and auditor independence should be a key consideration.
- *Assessing potential and continuing auditors* (Section 3.4): in assessing the auditors, and the adequacy and appropriateness of audit resources, audit committees should consider matters such as the auditor's knowledge of the listed company's business and industry, the extent of involvement of senior team members in the audit, use of other auditors, use of technical and specialist expertise, the capability accessible by the auditor in different geographical locations, coverage of internal systems and controls, and how the engagement partner and team are accountable within their firm for audit quality.
- *What matters should be considered in setting audit fees* (Section 3.5): audit committees should consider the extent to which audit fees are consistent with the audit plan and a quality audit.
- *Facilitating the audit process* (Section 3.6): audit committees role should promote quality and timely reporting by seeking explanations and advice on the appropriateness of accounting treatments and estimates, proper books and records, and systems and controls, which can facilitate a quality audit and avoid issues being missed or not adequately addressed due to deadline pressures.

- *Assessing auditor independence* (Section 3.7): audit committees should review and challenge management's accounting treatments and estimates, and should not feel encumbered by management to consult with, when considered necessary, an external party (for example and as applicable, a regulator) in carrying out their duties. The audit committee should oversee the development of policies on auditor independence, undertake procedures to satisfy itself on the independence of the auditor and require non-audit services to be subject to its prior approval, and consider other matters affecting auditor independence.
- *Communicating with the auditor* (Section 3.8): audit committees should have open, timely and meaningful communication with auditors about risks, issues and other matters to assist each of them in performing their respective roles in overseeing the financial reporting process and conducting a quality audit.
- *Assessing audit quality* (Section 3.9): audit committees should assess audit quality with regard to enquiry, observation and how the auditor addresses findings by audit regulators.

This report also refers to the possibility of voluntary public reporting by audit committees on their support for audit quality (Section 4.1).

Chapter 2 – The Role of Audit Committees and Audit Quality

2.1 Introduction

The IOSCO objectives of securities regulation are protecting investors, ensuring that markets are fair, efficient, and transparent, and reducing systemic risk. IOSCO considers the accuracy, integrity, and comparability of listed company disclosure to be essential for maintaining investor confidence and effective functioning of capital markets. One of the IOSCO principles for listed companies is that there should be full, accurate, and timely disclosure of financial results, risk, and other information that is material to investors' decisions.

Given the remit of securities regulators focuses on confident and informed markets and investors, IOSCO has an interest in both the quality of financial reports, which is supported by quality audits, and good corporate governance, which includes the role of the audit committee.

The quality of financial reports is key to confident and informed markets and investors. The objective of the independent audit is to provide confidence in the quality of financial reports. Improving audit quality and the consistency of audit execution is essential to continued confidence in the independent opinion expressed by auditors.

While the auditor has the primarily responsibility for the quality of the audit, IOSCO has produced this report because it considers that effective audit committees can support audit quality in the interests of market confidence in the quality of information in the financial reports of listed companies. Our good practices report is intended to assist audit committees in considering ways in which they may be able to promote and support audit quality.

In preparing this report, IOSCO has considered the experiences of its member organisations and aspects of audit committee practices in IOSCO Report FR04/2016 *Survey Report on Audit Committee Oversight of Auditors* dated May 2016 (the report can be found at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD531.pdf>).

IOSCO also considered the responses to the *IOSCO Consultation Report Good Practices for Audit Committees in Supporting Audit Quality*, issued in April 2018 and found at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD600.pdf>

Listed companies have primary responsibility for the quality of the financial report. It is not the purpose of this report to outline the roles and responsibilities of parties such as a governing board, audit committee and management which may differ between jurisdictions.

Irrespective of the good practices outlined in this report, audit committees should follow any laws and regulations of national or other jurisdictions that apply to the listed company.

2.2 About Governance Structures and Audit Committees

The exact form of an entity’s governance structure and the roles that any individual governance bodies perform in relation to the external auditor may vary depending on the requirements of national laws. In some jurisdictions, a single body commonly known as an “audit committee” oversees all matters relating to the external auditor. In other jurisdictions, more than one body within the governance structure of a listed entity may assume this responsibility.

For ease of reference, this paper uses the term “audit committee” to refer to any governance body or bodies that promote and support audit quality, regardless of whether they have that title.

Not all measures described in this paper may be able to be applied under the legal framework and governance structures in some jurisdictions. For example, in some jurisdictions there may be a supervisory board of non-executive members who choose executive directors to form an executive board. Some aspects of the role of the audit committee may be performed by the supervisory board or a subset of that board, but not other aspects.

2.3 Why is Audit Quality Important?

Auditors play a critical role in ensuring that investors can be confident and informed when making investment decisions. High-quality audits support the quality of financial reports and enable investors to rely on the auditor’s independent assessment of those reports.

In IOSCO’s view, audit quality relates to matters that affect the auditor's ability to:

- (a) achieve an audit's fundamental objective: to obtain reasonable assurance that the financial report as a whole is free of material misstatement; and
- (b) ensure that any material misstatements detected are addressed or communicated through the audit report³.

2.4 What Factors Influence Audit Quality?

Audit firms can influence audit quality through a range of factors including:

- an audit firm’s culture and focus on audit quality and professional scepticism, including how and to what extent the firm holds engagement partners and others in the firm accountable for audit quality (e.g. impact on remuneration for poor internal and external quality review findings);
- the auditor’s understanding of the business and the risks affecting the financial report;

³ In at least one jurisdiction the regulator does not accept qualified audit reports.

- the internal and external experience and expertise applied in audits (including recruitment and training, the use of experts, specialist industry knowledge, time allocated to an audit, and seniority of audit team members);
- how effectively audit engagements are supervised and reviewed within the engagement team and firm (both during the audit and post-audit quality reviews of the firm); and
- monitoring compliance with quality controls, including for auditor independence requirements.

While the auditor has primary responsibility for audit quality, this report suggests that audit committees should consider these and other factors in supporting audit quality. Audit committees may also consider how the auditor addresses the results of inspections by independent audit regulators.

2.5 What are the Auditor's Responsibilities?

Generally, the auditor of a listed company is required by national laws and, where applicable, auditing standards⁴ to:

- form an opinion about whether the financial report complies with relevant accounting standards and, where applicable, gives a true and fair view of, or presents fairly⁵, the financial position, financial performance and cash flows of the entity in all material respects⁶; and
- conduct their audit in accordance with the relevant auditing standards.

An auditor is also required to:

- meet independence requirements in rules, regulations or standards;
- read information accompanying the audited financial report for material inconsistency with the audited financial report, and for material misstatements of fact; and
- report in certain circumstances on suspected⁷ contraventions of particular rules and regulations to a securities or other regulator.

2.6 Audit Committees and Auditors

Audit committees should promote and support the quality of the audit through their various responsibilities. Among other things, those responsibilities can include making

⁴ It is not intended to detail all requirements of auditing standards in this section.

⁵ This should not be taken to imply that there is, or is not, a true and fair view or present fairly override to compliance accounting standards in any specific jurisdictions.

⁶ The opinion may or may not include the words “in all material respects” depending upon the requirements of each jurisdiction.

⁷ In some jurisdictions the specific test may vary, such as “possible” rather than “suspected”.

recommendations on the selection and appointment of auditors and approving the overall audit fees. Audit committees are also generally tasked with supporting the quality of the work of the auditor, which can include matters such as: considering whether the audit strategy addresses key risks, making inquiries regarding whether the audit is resourced with appropriate experience and expertise, assessing the performance of the auditor in relation to audit quality, and understanding whether the auditor has exercised appropriate professional scepticism. In many jurisdictions, the audit committee is also responsible for the oversight of the independence of the auditor, which may include the review and approval of non-audit services provided by the auditor.

Open, timely and meaningful communication between the audit committee and the auditor is important in fulfilling the responsibilities of both the auditor and audit committee. In addition, the audit committee in its oversight role is involved in the financial reporting process that ultimately impacts the annual financial report and year-end audit. These activities might also include reviewing interim financial reports and other periodic disclosure documents.

2.7 What are the Roles of Directors and Audit Committees in Relation to Audit?

For this report, an “audit committee” is any governance body or bodies that promote and support audit quality, regardless of whether they have that title. Insofar as this report deals with financial reporting quality, the audit committee is assumed to be a subcommittee of the board of directors⁸ that focuses on issues relevant to the integrity of the company’s financial reporting.

While the existence of an audit committee does not alter the need for all directors of the overall governing board to take responsibility for financial reports, audit committees can play an important role in the financial reporting process and in supporting and promoting audit quality.

The auditor gives an independent opinion that, in most jurisdictions, is given after the directors’ give their opinion on a financial report. A company must have its own systems, processes and controls, as well as appropriate resources, to produce high-quality financial reports. Directors or management (as applicable) must not rely on the auditor when forming their own opinion on the financial report⁹ as this would undermine the objective of an audit, which is to obtain reasonable assurance and provide an independent opinion

⁸ In some jurisdictions, audit committees may include individuals who are not directors.

⁹ While the directors and management do not rely on the auditor, the auditor would still communicate any concerns with the financial report identified in their independent audit so as to give the directors and management an opportunity to amend the financial report so that the market is properly informed through the financial report itself, rather than receiving a modified audit opinion. In at least one jurisdiction, management is responsible for the financial report and the directors do not form an opinion on the financial report.

on the financial report. However, in some jurisdictions, the auditor may be required to address their audit report to the board of directors and members/shareholders.

Audit committees should consider raising any audit quality concerns that are not satisfactorily resolved with the auditor with the board of directors as well as the auditor. Directors and audit committees may ask that the company's management seek external advice where appropriate, and may raise concerns with the relevant regulator if needed.

2.8 What is the role of directors and audit committees in overseeing management on financial reporting as relevant to audit quality?

The description of the roles of directors, audit committees and management in this section may not apply under the legal framework and governance structures in some jurisdictions. The description is provided to the extent necessary to provide context for the good practices in Section 3.6 of the report concerning oversight of management in relation to quality systems, processes, records analyses and reporting.

The audit committee should have a key oversight role with respect to the quality of financial information produced by management, and the quality of records and analyses supporting the financial report. High quality information produced by management will enable auditors to conduct a more efficient and effective audit that focuses on their role of providing an independent opinion on the financial report.

The audit committee should assist the board by reviewing significant financial reporting issues and judgements made in connection with the preparation of the company's financial statements (including having regard to matters communicated to it by the auditor), interim reports, preliminary announcements, and related formal statements. This includes considering whether management has adopted appropriate accounting policies, made appropriate estimates and judgements, and made appropriate disclosures.

In some jurisdictions directors are responsible for the quality of the financial report.¹⁰ Listed companies must also have appropriate systems, processes, controls and records to support information in the financial report and must not rely on the auditor, whose role is to provide an independent opinion to investors and other users of the financial report. While the direct responsibility for preparing the financial report and for related systems, processes and controls may be the responsibility of or delegated to management, the audit committee should oversee these aspects and question management about the preparation of quality financial information.

¹⁰ In many jurisdictions, the directors have direct statutory responsibility for the financial report but delegate to management and oversee management. In other jurisdictions, management has direct primary responsibility for the financial report and related systems, processes and controls, and the directors may oversee management.

Listed companies should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

While directors are not expected to be accounting experts, they should seek explanation and advice supporting the accounting treatments chosen by management and, where appropriate, challenge the accounting estimates and treatments applied in the financial report. They should not feel encumbered by management to consult with, when considered necessary, an external party (for example and as applicable, a regulator) in carrying out their duties where a treatment chosen by management does not reflect their understanding of the substance of an arrangement.

Where the auditor disagrees with management on an accounting treatment, accounting estimate or disclosure and the matter is not resolved, the audit committee should gain an understanding of both positions in forming its own view.

The audit committee and auditors should have open communications, both with and without management being present, on matters that can affect the quality of financial reporting, including systems, processes, risks and key reporting issues.

2.9 Internal audit

This report only covers the role of audit committees in supporting and promoting the quality of the external audit. The role of the audit committee in relation to any internal audit activities is outside the scope of this report.

A strong internal audit function can contribute to good corporate governance by providing an organisation's directors and audit committee with independent reviews of, and suggestions for, improving the design and operation of the organisation's financial and non-financial control environment, processes for identifying and monitoring risks, and governance processes.

Chapter 3 –Good practices for Audit Committees in Supporting Audit Quality

3.1 How can Audit Committees Support Audit Quality?

To support audit quality, audit committees should consider certain good practice matters when:

- recommending the appointment¹¹ of an auditor to members/shareholders;
- assessing potential and continuing auditors;
- assessing the audit fees;
- facilitating the audit process;
- communicating with the auditor;
- assessing auditor independence; and
- assessing audit quality.

The matters that should be considered are listed under each of the sections in this chapter of this report that follow. The matters may also be considered for inclusion in some form in the charter or similar document (if any) of an audit committee.

3.2 Features of Audit Committees that Support Audit Quality

Good practices for the features of audit committees that may facilitate a committee in being more effective in promoting and supporting audit quality may include:

Matter	Good practices
Features of audit committees	<ol style="list-style-type: none">1. The audit committee should comprise only non-executive directors.2. Consideration should be given to whether all or a majority of audit committee members and the chair should be independent¹² with respect to matters such as financial and business interests with the company

¹¹ Appointment includes reappointment of the existing auditor, where applicable. It is important that the audit committee regularly reassesses the auditor's performance and capabilities, and takes appropriate actions to promote audit quality. This could include replacing the auditor. Disagreements with management on accounting treatments or estimates should not be a basis for terminating the auditor's mandate, as opposed to matters such as the auditor's experience, expertise and capacity.

¹² There may be different understandings of approaches regarding independence of board members in different jurisdictions (see also 2007 IOSCO report *Board Independence of Listed Companies*).

Matter	Good practices
	<p>and length of tenure, acknowledging that different concepts of independence may apply in different jurisdictions.</p> <ol style="list-style-type: none"> <li data-bbox="587 501 1337 701">3. At least one member of the audit committee, preferably the chair, should have a good knowledge of financial reporting and/or audit (including accounting, auditing and auditor independence requirements). <li data-bbox="587 725 1337 1099">4. Audit committee members as a whole should between them have an appropriate understanding of financial reporting and audit, and knowledge of the industry in which the company operates. There should be some introductory and periodic ongoing training for audit committee members in financial reporting, audit and the industry in which the company operates to ensure their capabilities and skills are appropriate and up-to-date. <li data-bbox="587 1124 1337 1283">5. The audit committee chair should have demonstrated leadership qualities, strong communication skills, and be knowledgeable about the duties and responsibilities of the position. <li data-bbox="587 1308 1337 1467">6. Consideration could be given to skills and diversity of members of the board of directors and audit committee to discharge their responsibilities. Rotation may be considered, if appropriate. <li data-bbox="587 1491 1337 1650">7. Audit committee members should maintain professional scepticism and a questioning attitude toward the information received from management and in considering the quality of the audit. <li data-bbox="587 1675 1337 2002">8. Consideration should be given to how often the audit committee should meet. The audit committee should meet sufficiently frequently to meet its responsibilities on a timely basis. Regard may be given to factors such as the annual and interim financial reporting processes, the audit committee's role in the entity meeting certain market disclosure obligations (e.g, any continuous disclosure

Matter	Good practices
	<p>obligations), the complexity of the business, and the need to approve non-audit services. In some cases, ad hoc meetings, teleconferences or email exchanges may also be considered.</p> <ol style="list-style-type: none"> <li data-bbox="587 539 1337 658">9. The audit committee should be established with a mandate that permits it to carry out its responsibilities free of any unreasonable restraints.¹³ <li data-bbox="587 683 1337 801">10. The audit committee should have appropriate support of a secretary or other appropriate resources for its role. <li data-bbox="587 826 1337 945">11. The audit committee should have sufficient capacity for its roles, and be effective in its role in relation to financial reporting and audit quality. <li data-bbox="587 969 1337 1128">12. There should be open internal dialogue within the audit committee. All audit committee members should be encouraged to ask questions, express their views, be heard and have their views considered. <li data-bbox="587 1153 1337 1272">13. The audit committee should be the key representative body with which the external auditor interacts.¹⁴ <li data-bbox="587 1296 1337 1456">14. The audit committee should report to the full board on the audit committee's activities to support audit quality¹⁵, including how issues raised by the auditor were addressed. <li data-bbox="587 1480 1337 1599">15. The audit committee should conduct peer assessments of the performance of each of its members and assessments of its own effectiveness.

¹³ This good practice matter was derived from the principles outlined in the IOSCO Statement *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* issued in October 2002. As such the principle has already been settled by IOSCO.

¹⁴ As per footnote 13.

¹⁵ Refer section 4 regarding any public reporting of the audit committee's activities in supporting audit quality.

These good practices apply to all issuers, irrespective of their size. However, audit committee practices (e.g. the frequency of meetings) may vary depending upon the size and complexity of the issuer.

There may be additional considerations having regard to the circumstances of the entity such as the existence of a dominant chief executive officer or the protecting the interests of minority shareholders. For example, it may be necessary to consider any additional capabilities of, or other requirements for, those selected to be members of the audit committee or defining the role of the audit committee.

IOSCO Report FR04/2016 *Survey Report on Audit Committee Oversight of Auditors* dated May 2016 provides survey results across 47 jurisdictions on matters such as audit committee composition, audit committee independence, audit committee skills and expertise, and the source of requirements for audit committees. The survey report also includes survey results on requirements relating to auditors, such as selection of auditors, auditor independence and communications with auditors.

3.3 Recommending the Appointment¹⁶ of an Auditor

In some jurisdictions, the audit committee is responsible for appointing the auditors and sets their remuneration. In other jurisdictions, the members/shareholders of a listed company appoint the auditor at an annual general meeting (AGM). Even in the latter jurisdictions, because it is generally not practical for members/shareholders of larger listed companies to be involved in a detailed assessment of auditors and the determination of audit fees, the audit committee and directors can play an important role in recommending the appointment of an auditor.

In this context, management should not have sole responsibility for setting audit fees. It is possible that management may have interests that are not fully aligned with the conduct of quality audits, and so may not be best placed to assess auditors and set audit fees. For example, management is often evaluated on financial performance and is sensitive to cost pressures, which may lead to setting low audit fees that could adversely affect audit quality.

Where the audit committee is not composed solely of non-executive (independent) directors, non-executive directors should be responsible for the process of developing a

¹⁶ Appointment includes reappointment of the existing auditor, where applicable. It is important that the audit committee regularly reassesses the auditor's performance and capabilities, and takes appropriate actions to promote audit quality. This could include replacing the auditor. Disagreements with management on accounting treatments or estimates should not be a basis for terminating the auditor's mandate, as opposed to matters such as the auditor's experience, expertise and capacity.

recommendation on selecting, appointing and replacing auditors and the process of determining their remuneration.

Good practices for audit committees when recommending the appointment of an auditor may include:

Matter	Good practices
Any audit tender or other selection process	<p>The audit committee should ensure that:</p> <ol style="list-style-type: none"> 16. Any audit tender or other selection process is conducted independently of the company's management (i.e. using a panel of non-executive directors). 17. Audit tender or selection criteria, which should generally be set at the start of the tender/selection process, are focused on audit quality. 18. Audit fees are not reduced where this may compromise audit quality (e.g. by inadequate resourcing or insufficient work being performed). 19. Requests for tenders include objective criteria relating to both audit quality and fees with fees not being given undue weight in selecting an auditor. 20. Auditors are assessed against the criteria and selected having regard to audit quality, including skills, expertise, technical competence, industry knowledge, and resource capacity. One way to achieve this might be for the part of any tender document relating to quality to be considered before reviewing the proposed fees. This may provide an effective safeguard that a decision is not unduly influenced by a low audit fee in circumstances where audit quality may be compromised. 21. A smaller firm is not excluded based only on size if it is the firm that best meets the selection criteria and any other audit quality considerations as well as independence considerations. 22. Generally, there is a tender process where the eligible firms can bid and the firms are given appropriate access to management to understand the

Matter	Good practices
	<p>business and key risk areas so as to determine the nature, timing and extent of audit work, as well as the resources and expertise required for the audit.</p> <p>23. Potential auditors are not asked for their views on contentious judgements or accounting treatments affecting the company’s financial reports before their selection (also known as ‘opinion shopping’). It may be relevant to ask general questions to ascertain the technical competence or industry knowledge of an auditor, provided such questions could not be regarded as opinion shopping.</p> <p>24. Potential auditors are asked to confirm that, after appropriate due diligence, they are not aware of any matters affecting their independence.</p> <p>25. Consideration is given to any over familiarity with management of the incumbent auditor, particularly if there haven’t been sufficiently recent partner rotation or changes in management, and there are no unusual circumstances (beyond the need for an incoming auditor to invest to understand the business and risks) where a change in auditors has the potential to compromise audit quality.</p> <p>26. When selecting an auditor to recommend for appointment, the audit committee satisfies itself that the auditor is independent in accordance with applicable standards.¹⁷ See also Section 3.7.</p>
Commitment to audit quality	<p>The audit committee should assess whether:</p> <p>27. The auditor (including any incumbent auditor) has demonstrated a commitment to audit quality and to consider whether the audit committee or management is aware of any indication that the firm may not have a culture that sufficiently promotes audit quality.</p>

¹⁷ As per footnote 13.

Matter	Good practices
	<p>28. Any information relevant to audit quality in the audit firm’s annual audit transparency report (if any) is reviewed by the audit committee.</p> <p>29. The auditor adequately addresses any general findings reported publicly by an audit oversight regulator from audit firm inspections, as well as any firm and engagement specific findings from inspections of the firm and from the firm’s own internal quality reviews.</p>

See also ‘3.4 Assessing potential and continuing auditors’ for other matters that may be relevant.

3.4 Assessing Potential and Continuing Auditors

Audit committees should understand the audit process, risks identified by the auditor, the auditor’s planned responses to the identified risks, etc. It is important that the auditor is committed to devoting an appropriate level of resources with appropriate skills and expertise for the audit.

Matter	Good practices
Resources devoted to the audit	<p>The audit committee should assess whether:</p> <p>30. The auditor demonstrates a sufficient understanding of the business, operations and risk areas relevant to the financial report, and plans to respond appropriately to assessed risks. In a tender process, sufficient access would normally be provided to management for a prospective auditor to obtain an understanding of the business, operations and risk areas.</p> <p>31. The auditor’s engagement partner, engagement quality control review partner and audit team members have sufficient experience and expertise, given the size and complexity of the company and its operations. This includes relevant industry expertise, and valuation expertise (including expertise engaged</p>

Matter	Good practices
	<p>directly by the auditor from a third party) appropriate for the types of assets, liabilities and exposures of the company. The audit committee may also wish to consider encouraging the audit firm to consult with the audit committee on any change in partners or key audit team members to ensure that audit quality is maintained.</p> <p>32. Senior audit team members (particularly the engagement partner) are sufficiently involved throughout the audit, including at critical times, and demonstrate a good knowledge of the company's businesses, the industry and environments in which it operates, risk areas and key issues.</p> <p>33. The audit firm has adequate arrangements for supervising and reviewing the audit, and adequate internal firm quality reviews and controls, including in connection with foreign and domestic component audits.</p> <p>34. The auditor demonstrated their ability and capacity to adequately cover audit work in geographical locations in which components of the company's group operate.</p>
<p>Reliance on experts and other auditors</p>	<p>The audit committee should consider the extent to which:</p> <p>35. The auditor directly uses their own firm's specialised resources or engages external experts to supplement the audit team's experience and expertise in specialist areas by obtaining an independent view on the work of company management and any external specialists engaged by the company. For example, for complex asset and financial instrument valuations, the auditor could use their own specialists such as geologists, chemists, actuaries, corporate valuers or treasury experts. For revenue recognition, the auditor might</p>

Matter	Good practices
	<p>engage their own industry expert to assess the stage of completion of a project.</p> <p>36. Where the auditor uses the work of other auditors for audit work on components within a group (e.g. local or foreign branches, and subsidiaries), the auditor has processes to determine that their participation in the audit is sufficient and to satisfy the auditor regarding the qualifications and the work of other auditors.</p> <p>37. The auditor will not inappropriately use or rely on internal auditors to perform external audit work.¹⁸</p>
Audit strategy and scope	<p>The audit committee should assess whether:</p> <p>38. A continuing auditor has prepared a plan for the audit for discussion with the audit committee that includes the audit strategy and scope. The audit committee should review any such plan with regard to whether the auditor plans to address risks known to audit committee members (see also Section 3.8).</p> <p>39. The auditor has considered their approach to reviewing or testing significant systems and controls supporting information in the financial report in a particular year. Similarly, the audit committee may consider whether the coverage of component auditors to perform work at particular operations or locations is appropriate.</p>
Accountability	<p>40. The audit committee should discuss with the audit engagement partner how the audit firm and its</p>

¹⁸ In some jurisdictions, external auditors may not use internal auditors to perform external audit work and are only allowed to rely on the work of internal auditors as a part of the company's own internal control processes and when identifying risks of material misstatement. In other jurisdictions, the external auditor may be able to substitute internal audit work (e.g. tests of detail) for their own work, subject to appropriate review and reperformance. In these latter jurisdictions, the audit committee may wish to consider whether the extent of reliance on internal audit as a substitute for external audit work is appropriate.

Matter	Good practices
	<p>affiliate firms, engagement partner, review partner, specialists and audit team members are appropriately held accountable for audit quality within their firm or network. For example, audit quality is a key consideration in performance assessments and setting remuneration.</p>

See '3.9 Assessing audit quality' for other matters that may be relevant.

3.5 Setting Audit Fees

A company should pay the auditor's reasonable fees and expenses. The setting of audit fees is a commercial decision by companies and their auditors. The process should be managed by the directors (who should be responsible for setting the overall fee¹⁹) and the audit committee. Directors and audit committees should consider whether audit fees are reasonable for the work required to conduct a quality audit in the interests of investors and other users of the financial report, and not set at a level that could lead to audit quality being compromised.

Auditors may be faced with challenging judgements in areas such as assessing whether a company is a going concern, impairments of assets and fair values. This increases the time spent on an audit and might be expected to increase audit fees. Changes in the company's business, reporting requirements, internal control environment or the risks affecting financial reports may also warrant increases in fees.

There may be a temptation to reduce audit fees in the pursuit of general cost reductions. Cost should not be a consideration if that may adversely affect audit quality, particularly where a company may be under financial pressure and more audit effort may be required. In any event, audit fees are usually a small proportion of costs, and reducing them does not generally have a significant impact on a company's profit.

If a company decides to seek tenders for audit services, the primary focus should be on audit quality rather than on reducing costs. A quality audit enhances the credibility of the company's financial report.

Some audit firms may offer discounted fees to maintain or increase revenues, contribute to fixed costs, occupy staff during downturns, maintain or build market share, or build a

¹⁹ In some jurisdictions, the audit fees are set by a supervisory board.

presence in a particular industry. In some cases, an auditor may not have understood the company's business, reporting requirements and the extent of audit work required.

While there may be instances where an effective but more efficient audit can be obtained for a lower fee, audit committees and directors should be aware of pressures in some audit firms to limit the impacts of low or reduced fees on margins. Inadequate fees can create a risk that audit quality is compromised and that auditors do not obtain sufficient and appropriate audit evidence to support their opinion.

Matter	Good practices
Setting audit fees	<p>The audit committee should assess whether:</p> <ol style="list-style-type: none"> 41. The audit fees charged by the auditor appear adequate in relation to the work required to support an audit opinion without regard to fees that might be paid to the auditor for other services.²⁰ 42. Audit fees are consistent with the auditor's overall plan, and are sufficient to support the execution of an appropriately resourced and effective audit. Audit committees may wish to consider the level of audit fees is adequate with regard to matters such as: (i) any risks, judgements and estimates to be addressed by the auditor; (ii) changes in the business or financial reporting requirements; and (iii) appropriate benchmarking against similar businesses. Audit committees may also wish to challenge the reasons for any reduction in audit fees. 43. There is any indication that audit quality may be compromised by reduced audit fees causing the audit to be inadequately resourced or insufficient work performed. 44. Audit fees reflect changes in risks, new businesses, new complex transactions, etc.

3.6 Facilitating the Audit Process

Not all measures described in this section of the report may be able to be applied under the legal framework and governance structures in some jurisdictions.

²⁰ As per footnote 13.

Matter	Good practices
Supporting the audit	<p>The audit committee should consider the extent to which:</p> <p>45. Financial reporting processes and audit processes are planned so that an effective quality audit can be conducted within the financial reporting deadlines.</p> <p>46. The audit committee seeks explanations and advice supporting the accounting treatments chosen and, where appropriate, challenges the accounting estimates and treatments applied in the financial report. The audit committee should particularly seek external professional advice where a treatment does not reflect their understanding of the substance of an arrangement.</p> <p>47. Any concerns or risks highlighted by the auditor (for example, in comment letters from the auditor to the governing board), including concerns about systems, processes or policies that could materially affect future financial reports, are considered and addressed.</p>
Company management and staff	<p>The audit committee should take reasonable steps to ensure that:</p> <p>48. Management has a tone and the company has a culture focused on financial reporting quality.</p> <p>49. There are appropriate accountability and incentives for company management and staff to focus on the quality of financial reporting, timely reporting and facilitation of the audit process.</p> <p>50. Management has produced all information, records, and explanations that may be relevant to the financial report and audit in a timely manner. Information should be supported by appropriate analysis and documentation, particularly for key accounting estimates and judgements.</p> <p>The audit committee should:</p>

Matter	Good practices
	<p>51. Encourage management and staff to have a positive and helpful approach to the audit process, and make enquiries of the auditor as to whether there has been a lack of cooperation. The auditor should be encouraged to raise any lack of cooperation and appropriate action should be taken by the audit committee to ensure that any lack of cooperation is addressed.</p>

3.7 Assessing Auditor Independence

The audit committee should assess auditor independence. The independence of the auditor (both in fact and appearance) is important for promoting market confidence in the auditor’s report on the financial report. Actual and perceived independence, including from directors and company management, as well as the objectivity of the auditor, underpins audit quality.

It is important for directors and audit committees to evaluate the independence of the auditor – both when recommending the appointment of auditors and on an ongoing basis.

In many jurisdictions audit fees and fees for non-audit services are required to be disclosed in the financial report. There may also be a requirement to disclose whether the non-audit services were approved in advance by the audit committee. This information may be a useful indicator of audit independence and also the adequacy of audit fees in the context of audit quality.

In considering auditor independence, the term “auditor” should be broadly construed to include not only an individual engagement partner but also, for example, members of the audit team, the firm itself, and related entities of the firm such as what is sometimes termed a “network firm”.

Matter	Good practices
<p>Independence and objectivity</p>	<p>The audit committee should take reasonable steps to ensure that:</p> <p>52. When audit committee members challenge complex accounting policy choices and estimates, they should have regard to their knowledge of the business and the substance of any arrangements.</p>

Matter	Good practices
	<p>This may include not feeling encumbered by management in consulting with, when considered necessary, an external party (for example and as applicable, a regulator) in carrying out their duties. Management or the directors, depending on the jurisdiction, remain responsible for the accounting treatments applied and estimates made in the company's financial report. The auditor remains responsible for the independent audit. Where the auditor disagrees with management on an accounting treatment, accounting estimate or disclosure and the matter is not resolved, the audit committee should gain an understanding of both positions providing oversight of management's responsibility for the financial statements or forming its own view in meeting the director's responsibility for the financial statements.</p> <p>53. The audit committee has a policy regarding how to evaluate the auditor's independence.</p> <p>The audit committee should:</p> <p>54. Oversee establishment of the company's policies governing the circumstances in which contracts for the provision of permitted non-audit services can be entered into with the auditor and the procedures that must be followed before doing so.²¹</p> <p>55. Consider implementing a policy that all non-audit services to be provided by the auditor must be approved in advance by the audit committee.²²</p>

²¹ This good practice matter was derived from the principles outlined in the IOSCO Statement *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence* issued in October 2002. As such the principle has already been settled by IOSCO. Please refer to the October 2002 IOSCO Statement for further guidance in relation to this principle.

²² As per footnote 13.

Matter	Good practices
	<p>56. Establish policies relating to the hiring from an entity’s audit firm of senior officers for the entity, including the Chief Executive Officer and the Chief Financial Officer.²³</p> <p>57. Undertake procedures to satisfy itself, both initially and on an ongoing basis, as to the auditor’s independence.²⁴</p> <p>58. Consider any other matters that may affect the independence and objectivity of the auditor, including independence of auditors of domestic and foreign components (e.g. controlled entities, associates, joint arrangements and structured entities).</p> <p>59. Discuss with the auditors, at least annually, matters relating to their independence, including all significant threats to independence identified by the auditors and the safeguards implemented.²⁵</p>
Reporting to members/investors/ shareholders	<p>The audit committee should:</p> <p>60. Report to the shareholders on the actions it has taken to safeguard the independence of the auditor, including satisfying itself that the auditor is independent in accordance with applicable standards.²⁶</p>

3.8 Communicating with the Auditor

An audit committee should establish a direct line of communication between the audit committee and the auditor. The quality of communications between directors and audit committees and the auditor is important in supporting audit quality. This communication should include concerns and risks affecting the processes which support the information

²³ As per footnote 13.

²⁴ As per footnote 13.

²⁵ As per footnote 13.

²⁶ As per footnote 13.

in the financial report, and how these concerns and risks are being addressed by directors and management and responded to in the audit.

Open, timely and meaningful communication between the auditor and the audit committee is important in fulfilling the responsibilities of both the auditor and audit committee. Two-way communication between the auditor and the audit committee members helps the auditor to obtain information that is relevant to the audit and assists the audit committee and directors in overseeing the financial reporting process.

There may also be instances where the audit committee’s communications with the auditor include the auditor’s experts or members of the audit team who have detailed knowledge of particular matters.

Communications between the auditor and the audit committee must not undermine the auditor’s independence or the effectiveness of performance of the audit or auditing procedures.

Matter	Good practices
Addressing any relevant risk areas or areas of concern	<p>The audit committee should take reasonable steps to focus on the following:</p> <ol style="list-style-type: none"> <li data-bbox="587 1081 1334 1200">61. The audit committee discusses the overall audit strategy developed by the auditor and how it responds to risks known to the audit committee. <li data-bbox="587 1227 1334 1597">62. The audit committee and management inform the auditor in a timely manner about any relevant risks, judgements or significant concerns with accounting treatments, accounting estimates, accounting records, financial reporting systems and processes (e.g. internal control deficiencies) and fraud risks so that any matters may be properly considered and addressed by the auditor in assessing risk and the auditor’s response as part of the independent audit. <li data-bbox="587 1624 1334 1821">63. The audit committee and management inform the auditor of the understanding of the business purpose of complex new transactions which may affect the accounting treatment, or uncertain accounting estimates. <li data-bbox="587 1848 1334 1966">64. The audit committee and management promptly inform the auditor of relevant correspondence or other communications from regulators or market

Matter	Good practices
	<p>operators (e.g. inquiries made, or concerns raised about, accounting policies, accounting estimates or material disclosures, or any matter that could have an impact on financial information reported to the market). The audit committee should also consider whether there are appropriate processes for its members to be promptly informed of any such communications.</p> <p>65. The auditor provides written reports on key issues and concerns, and these reports are considered and acted upon appropriately. These reports may include matters such as deficiencies in controls and errors identified by the auditor, and any significant concerns with accounting treatments and estimates. They may also include suspected non-compliances with laws and regulations.</p> <p>66. The auditor demonstrates professional scepticism in considering judgement areas such as accounting estimates and accounting policies.</p> <p>67. If Key Audit Matters (KAMs) or Critical Audit Matters (CAMs) are required to be disclosed in the audit report, the audit committee discusses draft KAMs/CAMs with the auditor and how these affect disclosures in the financial report of accounting policies and sources of estimation uncertainty or risks in the management discussion and analysis. The audit committee should consider the need for any issues to be addressed by management or the directors (e.g. addressed in the finalisation of the financial report or by improving systems and controls).</p> <p>68. Understanding the reasons for an incumbent auditor choosing to resign, and any issues that need to be addressed.</p>

Matter	Good practices
Ensuring access to directors and audit committee	<p>The audit committee should ensure that:</p> <p>69. There are established protocols for communications between the audit committee and the auditor, including setting clear expectations regarding the nature and method of communication.</p> <p>70. The auditor is allowed unfettered access to the audit committee or audit committee chair.</p> <p>71. The auditor is regularly invited to attend audit committee meetings, particularly where material issues concerning financial reporting are discussed. The audit committee should give the auditor the opportunity to attend those parts of meetings concerning issues relating to financial reporting matters, rather than those relating to matters such as appointment or assessment of the auditor.</p> <p>72. There is an open dialogue between the auditor and the audit committee on matters affecting the financial report, the audit and audit quality.</p> <p>73. The audit committee meets with the auditor without management present on a regular and frequent basis and discusses with the auditor any contentious issues that have arisen with management during the course of the audit and whether they have been resolved to the auditor's satisfaction. Minutes of these discussions should not be provided to management.</p> <p>74. Communications with the auditor are regularly reviewed and are effective in supporting audit quality.</p>

3.9 Assessing Audit Quality

Audit committees are well-placed to evaluate an auditor's performance, and can help to ensure that members receive a valuable independent audit opinion on the financial reports. This promotes market confidence in the company's financial reports.

Matter	Good practices
Quality and standards	75. The audit committee should consider whether there is any indication that the auditor is not committed to audit quality and the application of high ethical standards.
The audit process	<p>The audit committee should consider the extent to which:</p> <p>76. The auditor demonstrates a sufficient understanding of the business, operations and risk areas relevant to the financial report, and has responded appropriately to assessed risks.</p> <p>77. The auditor appears to exhibit sufficient professional scepticism in challenging, rather than rationalising, estimates and accounting policy choices (e.g. complex or subjective asset valuations, including cases where the reported net assets exceed the market capitalisation of the company).</p> <p>78. The auditor appears to address risks or concerns identified by the audit committee.</p>
Communication of issues	<p>The audit committee should consider the extent to which:</p> <p>79. The auditor raises key issues affecting the financial report in a timely manner.</p> <p>80. The auditor raises relevant and useful comments in their management letters.</p>
Other information	<p>The audit committee should consider the extent to which:</p> <p>81. Information relevant to audit quality in an audit firm's annual audit transparency report is reviewed.</p> <p>82. Any other information on audit quality is reviewed (e.g. internal company staff observations or assessments of audit quality).</p>

Matter	Good practices
	<p>83. The auditor takes actions to improve audit quality, and that there are measures and timetables in place to track progress of these actions.</p>
<p>Findings from regulatory audit inspections and surveillances</p>	<p>The audit committee should consider the extent to which:</p> <p>84. If a regulator selected the company's audit for review, the audit committee has considered the review's scope and results when evaluating the auditor's performance and the quality of the audit.</p> <p>85. Any overall public aggregate thematic findings from a regulator's inspections or surveillances that are common across many audit engagements are addressed.</p> <p>86. If the auditor indicated that findings of an audit oversight regulator from the review of the audit files for the specific company were not significant (e.g. mere documentation matters or matters where judgements reasonably differ), the audit committee challenges this, as regulators do not generally report insignificant findings.</p>

Chapter 4 – Other Matters

4.1 Audit Committee Reporting

While some jurisdictions require the audit committee to publicly report on how their oversight of the auditor and/or other actions support the quality of the audit,²⁷ there is currently no such requirement in most jurisdictions other than reporting on the role of the audit committee in relation to auditor independence.

To the extent not already required by law or regulation, audit committees might wish to consider whether to publicly voluntarily comment on the role of the audit committee in supporting audit quality, either in documents accompanying the financial report or another document (e.g. a statement on the company's website).²⁸ For example, consideration might be given to providing a discussion of the involvement of, and process undertaken by, the audit committee to support audit quality in recommending the appointment of auditors, assessing the auditor's ongoing performance, reviewing audit fees, or other areas.

²⁷ Reporting on the role of the audit committee in relation to auditor independence is required in a number of jurisdictions and is covered separately in Section 3.7.

²⁸ Except that the audit committee's role in relation to auditor independence is covered separately in Section 3.7.



Audit Quality Indicators Final Report

INTRODUCTION

Interested in getting started with AQIs?

Click [here](#) to access the *Audit Committee Guide to Audit Quality Indicators* developed by CPAB, CPA Canada and the Institute of Corporate Directors – a useful step-by-step process to help audit committees and management implement AQIs for the first time.

Audit quality is a challenge for audit committees to measure and evaluate. Audit Quality Indicators (AQIs) are a response to this and provide quantitative measures about the external audit process. They facilitate collaboration among key stakeholders (auditors, management and the audit committee), and provide more in-depth information to assist in evaluating and achieving sustained audit quality.

Jurisdictions around the world, including Canada, are experimenting with AQIs to drive audit quality. CPAB has recently concluded a two year exploratory AQI pilot project. This document summarizes our key observations.

CPAB believes that **AQIs have significant potential to positively impact audit quality.**

CPAB'S AQI PILOT

In 2016, CPAB launched an exploratory AQI Pilot project (Pilot) with six Canadian audit committees, their management and external auditors to get feedback about the usefulness of AQIs and to support broader national and international discussions. We expanded the Pilot in 2017 to 18 reporting issuers.

The following chart shows some of the reporting issuers who have participated in our Pilot over the last two years:

Reporting Issuer	Audit Committee Chair	Reporting Issuer	Audit Committee Chair
Air Canada	Chris Clark	Intact Financial	Eileen Mercier
ARC Resources Ltd.	Kathleen O'Neill	Magna International Inc.	Lawrence Worrall
Ballard Power	Douglas Hayhurst	NAV Canada	Linda Hohol
Bank of Montreal	Philip Orsino	Rogers Communications Inc.	John Clappison
Cogeco Communications Inc.	Joanne Ferstman	Royal Bank of Canada	David Denison
Cogeco Inc.	James Cherry	SMART REIT	Garry Foster
Hydro One Inc.	Philip Orsino	Sun Life Financial Inc.	Bill Anderson
iA Financial Group	Michael Hanley	Telus Corporation	Bill Mackinnon

CPAB's Pilot was exploratory and encouraged innovation in how audit committees approach the use of AQIs. While CPAB provided participants with guidance, no specific requirements were given regarding the number or type of AQIs to use. Participants were encouraged to determine how to work with AQIs in a way that best suited their objectives and areas of interest.

A set of initial AQIs were presented to the audit committee and then analyzed by the audit firm and management. CPAB had various touchpoints with participants, including a number of Roundtables, to collect feedback.

“ I really learned a lot through this process. I have been the chair of the audit committee for six years now, and I'm surprised at how much more I have learned about audit quality. ”

- Audit committee chair

BENEFITS AND CHALLENGES

Pilot participants identified the following benefits and challenges from using AQIs.

BENEFITS:

- A better understanding among management, the audit committee and the external auditor of roles and responsibilities related to audit quality, and their expectations of others.
- More efficient and effective interactions between the audit committee and the auditor – as discussions are focused on the most important areas of the audit.
- Improved knowledge of and engagement in the audit process and audit quality by audit committee members.
- Improved project management over the audit, including coordination and collaboration in audit execution.
- Better information for the purposes of auditor evaluation.

“ It was extremely useful for our organization to come up with common language for what audit quality is. ”

- Audit committee chair

“ We originally thought the AQI process would be difficult to scale to a small entity with our limited resources however we were pleasantly surprised at how easy it was to scale and tailor the AQIs to an entity of our size. ”

- Audit committee chair

These benefits enhance audit quality through an enriched understanding of expectations among stakeholders, improved coordination and cooperation in audit execution, and a more informed and engaged audit committees, resulting in improved oversight over the external audit process.

CHALLENGES:

- Determining relevant AQI measures.
- Evaluating AQIs, including the development of evaluation criteria and understanding causes for their variability.
- Changes required in audit firm systems and processes to facilitate reporting.

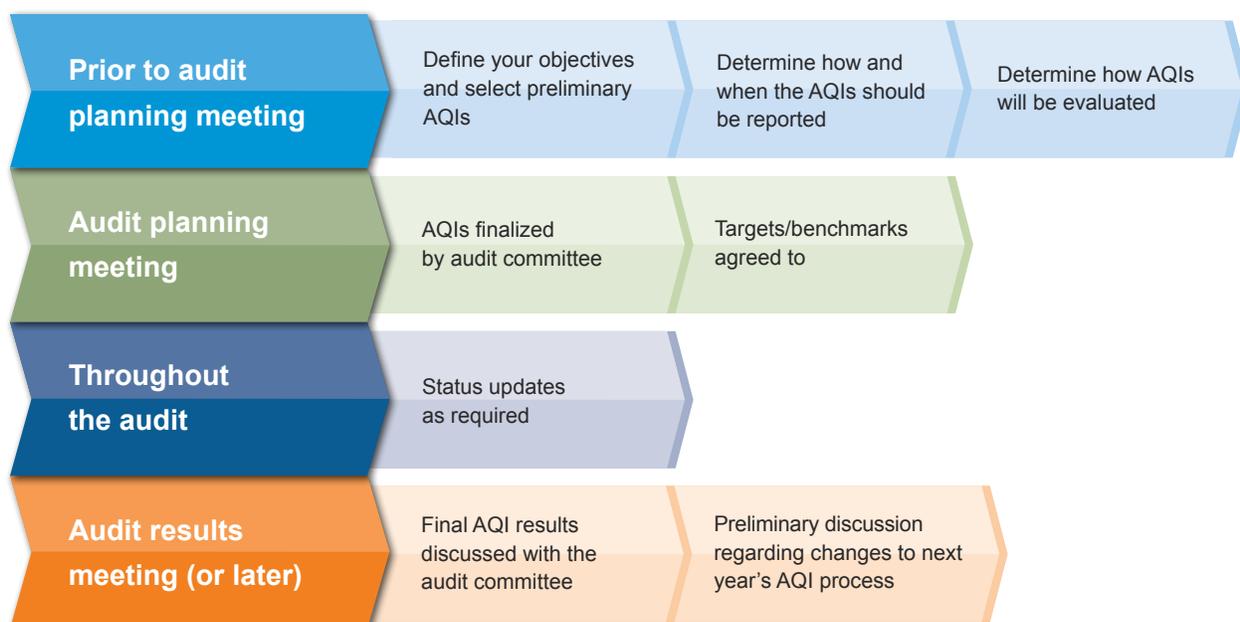
“ The first year you implement AQIs is the hardest, because you lack a historical baseline to help you evaluate your results. ”

- Audit committee chair

When using AQIs, it is important to remember that they are not the only means through which audit quality is managed or evaluated. The effective use of AQIs, including selecting, evaluating and interpreting AQIs, is a skill that will be built over time by audit committees, management and the audit firms.

IMPLEMENTING AQIs: THE PROCESS

Key to the effective use of AQIs is engagement in a collaborative process among management, the audit committee and the auditor.



MULTI-STAKEHOLDER DISCUSSION

Developing AQIs begins with an open conversation between management, the audit firm and the audit committee chair. While the main goals of the conversation are to determine the objectives in using AQIs, select AQIs and determine how they will be reported and evaluated, many participants noted that the most valuable part of the discussion was not about such practical matters. They said they gained the most value from understanding how each party defines audit quality, expectations around audit quality, and how to manage the coordination needed to achieve everyone's goals. Many participants stressed the importance of taking the time to ensure these conversations are sufficiently robust and agreed that they provided the greatest value in the process.

“ Much of the value of AQIs is created up front – during the initial discussions. ”

- Audit committee chair

DETERMINING OBJECTIVES

The objectives of Pilot participants varied and significantly influenced the selection of AQIs. Participants noted that AQIs were not the only tool available to the audit committees to meet their stated objective(s), and that their chosen AQIs would be considered in conjunction with other sources of information. Examples of objectives identified include:

- General audit oversight, including project management and monitoring of key audit risks.
- External auditor evaluation in terms of audit quality and client service.
- Monitoring and managing the added value provided by the auditor.

Real life examples:

One audit committee chair wanted to use AQIs to monitor “sensitive areas of interest to the audit committee”, including the adoption of new IFRS standards and financial reporting systems conversion.

At the suggestion of management, another audit committee chair used AQIs to improve oversight of the audit of areas of particular interest to investors/analysts, such as significant estimates.

SELECTING AQIs

The average number of AQIs selected was eight. Participants stressed the need to be thoughtful and focused when selecting indicators, and that a smaller number (10 or fewer) is ideal. Experienced participants noted they became better able to evaluate the cost-benefit provided by each of their selected AQIs by the end of the first year and, in some cases, reduced the number of AQIs by consolidating similar metrics.

In determining which AQIs to select, participants were encouraged to consider:

- The unique nature of their business.
- Their specific areas of significant audit risk.
- Areas of the audit they would like more transparency/information on.
- Factors most meaningful to them when evaluating their external auditor.
- Themes noted in the reports of external audit inspections including those from CPAB or the PCAOB.
- AQIs their external auditor and/or management are already tracking or considering for internal management purposes.
- The ability of their external auditor and/or management to provide information and have a meaningful discussion on the context surrounding the information.

“ Don’t pick too many AQIs – it’s the only way to avoid it being a compliance exercise. Be thoughtful, meaningful and focused. ”

- Management representative

Participants also considered these additional factors:

- Audit quality metrics their audit firm tracks for partner compensation purposes.
- Information provided by the audit firm in other reports (for example, as contractually required or requested for other purposes).
- Output from the annual or comprehensive auditor evaluation if performed in the same year.

There was significant variety in the types of AQIs selected. This relates partially to differing objectives, and also to the innovative mindset of the participants, some of whom attempted to develop novel measures.

Table 1: Examples of AQIs

Type	Indicator	Example Definitions
Engagement Team Indicators	Experience of engagement team	Delivery of agreed upon team skills (industry/specialty/client knowledge) Years of audit experience of key members of the engagement team
	Training and professional development	Number of hours and type of professional development and technical training attended by key engagement team members
	Turnover of engagement team	Turnover rates of key engagement team members and/or level
	Partner / manager involvement	Per cent of audit hours carried out by senior engagement team members compared to the entire engagement team
	Partner workload	Information about the level of work for which key engagement partners are responsible for and the number of claims on his or her attention

Type	Indicator	Example Definitions
Audit Execution Indicators	Audit hours by risk	Time spent by the engagement team on significant risk areas
	Timing of audit execution	Audit hours by phase (planning, interim, year-end)
	Audit progress milestones	A timeline for the completion of the audit which is mapped to key milestones within the process
	Technology in the audit	Use of technology initiatives in the audit, including information about areas of use, types of tools, number of hours, etc.
	Specialist engagement	Where and how much (measured in hours) persons with "specialized skill and knowledge" are used in the audit
	Service delivery centres	Amount of audit work centralized at service centres
Management Indicators	Management deliverables	Achievement of timing of agreed upon deliverables from management to the auditor
	Remediation of control deficiencies	Efficiency of remediation of 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
	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	Effective and timely communications between 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

REPORTING AQIs

Frequency

With the exception of the initial AQI conversation, reporting mechanisms and frequency varied. All participants agreed the best time for the audit firm to present the initial list of AQIs to the audit committee was during the audit planning meeting, as part of the audit plan. Frequency of reporting varied between quarterly, semi-annually, annually, or a combination of the three. Year-end reporting typically took place either at or after the year-end audit results meeting. Many participants noted that some form of regular communication on AQIs during the audit cycle was preferable to year-end only reporting.

Format

Most participants tracked AQI information in a standalone AQI report, typically produced by the auditor for the audit committee (see Figure 1).

Some participants noted that they may also consider integrating AQIs directly into their audit plan or other reports (such as auditor evaluation templates) in the future.

Figure 1

Name of AQI	Actual	Target	Difference
XXX	# / %	# / %	# / %
XXX	# / %	# / %	# / %
XXX	# / %	# / %	# / %

EVALUATING AQIs

Many AQIs listed in Table 1 above were selected by more than one participant, particularly the AQIs listed in the Engagement Team and Audit Execution categories. However, the way each measure was defined, reported and evaluated often differed, depending on the information capability of the audit firm and the needs of the audit committee.

Participants identified the development of evaluative criteria as the most significant challenge to using AQIs. This is especially true for first time AQI users. In the absence of historical data, the lack of an objective benchmark was considered particularly difficult. Participants raised both industry groups and audit firms as possible sources for objective benchmarks; they also suggested setting an acceptable range or directional trend as an alternative to setting a specific point value.

It was noted that it is essential to provide qualitative information to allow audit committee evaluation of each AQI. This is because there is typically no “right” answer for AQIs and the primary benefit is the discussion of the context surrounding the result of the AQI. For example, an increase in the number of hours

a partner spends on an audit engagement could mean improved audit quality (due to the increased involvement of an experienced auditor) or decreased audit quality (lower level staff were not competent requiring increased partner time to deal with numerous issues). Qualitative information provides important contextual facts to the audit committee enabling them to determine if the results are positive or negative indicators of audit quality or if additional attention is needed in a certain area.

“ Context is vital to understanding AQIs. ”

- Audit firm representative

WHAT WE LEARNED

DIVERSE OPINIONS ON THE USEFULNESS OF SPECIFIC AQIs

There are no silver bullet AQIs. Instead there is a range of perspectives depending on the unique needs and circumstances of individual audit committees. Table 2 to the right outlines AQIs selected by greater than 75 per cent of Pilot participants and are consistently identified as very useful by audit committees, management and audit firms. Reactions to all other indicators were mixed, from not useful to extremely useful. This illustrates the diverse perspectives of participants and their differing needs and goals.

Table 2: AQIs selected by more than 75 per cent of Pilot participants

Name of AQI
Timing of audit execution
Use of specialists
Partner/manager leverage
Experience of engagement team
Management deliverables
Audit hours by areas of significant risk

Illustrative Example: Workload AQI

This look at the Workload Indicator shows varying perspectives on specific indicators.

Example definitions	Example evaluative criteria
Absolute and percentage of hours dedicated to Company X, other client commitments and internal activities by Lead Audit Partner and Engagement Quality Control Reviewer	“The Lead Audit Partner and Engagement Quality Control Reviewer will devote X and X hours respectively to the client. Partners are normally expected to work X number of client service hours annually”.
Absolute and percentage of hours dedicated to Company X, other client commitments and internal activities by Lead Audit Partner and Engagement Quality Control Reviewer	“Our audit firm will meet the budgeted figures as listed below, per staffing level and specialist group:” Chart provided lists the following figures per staffing level and specialist group: (1) Planned average hours to be spent on the client in the current year (2) Planned average total client service hours in the current year (3) Actual average total client service hours in the previous year

When discussing the usefulness of the Workload indicator, participant perspectives varied. Some audit committee chairs felt that the workload of key partners was not important as long as the partners continued to deliver a quality audit. Others said it is important to understand the amount of pressure on key partners and their ability to make critical judgments. It was also noted that certain unique situations may result in increased interest in this indicator in a given year, such as: if it is a first year audit, if a significant transaction occurred during the year, or if a new audit partner is being rolled onto the engagement.

THE ENGAGEMENT TEAM IS CRITICAL TO AUDIT QUALITY

There was widespread acknowledgement that the composition of the engagement team is foundational to audit quality. Strong engagement teams are appropriately staffed, have the right mix of industry and specialist expertise, and include a diverse skillset which enables the team to exhibit appropriate professional skepticism and judgment. Half of the AQIs most frequently selected by Pilot participants were engagement team-related, as outlined in Table 2 above.

SUPPORT FOR MANAGEMENT-RELATED AQIS

During the first year of the Pilot, some participants developed AQIs to measure management's role in audit quality. The inclusion of these indicators provides a broader perspective to the audit committee highlighting the contribution of management to the successful completion of a high quality audit.

Insights obtained by audit committees from management indicators resulted in the majority of 2017 Pilot participants including an AQI to measure management's role in audit quality. While the most common indicator was project management-based (the achievement of timing of agreed upon deliverables from management to the auditor, for example), we saw innovation including indicators measuring the quality of management's control systems and the timeliness of management's remediation of control deficiencies.

Real life example

As a result of including a management AQI in their AQI profile, one audit committee discovered that over 40 per cent of management's deliverables were provided an average of five days late to the auditor. This insight resulted in actions from management that positively impacted audit quality.

PROJECT MANAGEMENT AND AUDIT QUALITY

The use of AQIs highlighted the importance of project management to audit quality. A number of participants used indicators related to tracking milestones or phases of the audit. These indicators typically held the audit firm accountable for meeting certain milestones by a specific date. For example, one audit firm provided the audit committee with a list of significant tasks (e.g. lead engagement partner sign-off on audit planning) and completion date. Another audit firm provided dates when a certain amount of the audit work was to be completed (e.g. 55 per cent of the audit to be completed before year end).

Benefits of using such AQIs included increased focus by the audit firm on project management, and improved coordination among management, the audit firm and the audit committee throughout the audit process. The discussion of such milestones highlighted the importance of management providing working papers to the audit firm on time.

EVOLUTION IS KEY

To keep AQIs out of the compliance trap, participants highlighted the need to reflect on them every year. Some experienced AQI participants modified their AQIs to reflect changes at the audit firm, business environment, audit risks, or needs of the audit committee. Others maintained their AQIs from the previous year as a baseline for future trending analysis.

Regardless, substantially all experienced Pilot participants felt that AQIs continued to provide them with positive value in the second year.

“ You need to re-evaluate your AQIs – both the specific indicators and associated targets – on an annual basis to reflect progress and changing circumstances. ”

- Audit committee chair

DISCLOSURE AND AUDIT COMMITTEE REPORTING

There was discussion about whether audit committees should disclose the use of AQIs in their annual filings, which some see as evidence of robust audit committee oversight of the external auditor. Several of our Pilot participants, such as Telus Corporation and Sun Life Financial, chose to publicly disclose their use of AQIs.

“ I wonder if we should be publicly disclosing our use of AQIs to demonstrate our oversight of the external auditor. ”

- Audit committee chair

INTERESTED IN USING AQIs?

AQIs can positively impact audit quality. We encourage you to use the following resources:

- (1) **Audit Committee Guide to Audit Quality Indicators:** Together with CPA Canada and the Institute of Corporate Directors, we developed a [short guide](#) to assist audit committees to implement AQIs for the first time. The 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. The Guide can be used in conjunction with the updated Enhancing Audit Quality (EAQ) publications:
 - a. Oversight of the External Auditor – [Guidance for Audit Committees](#),
 - b. Annual Assessment of the External Auditor – [Tool for Audit Committees](#),
 - c. Periodic Comprehensive Review of the External Auditor – [Tool for Audit Committees](#).

- (2) **AQI Network:** In 2018, CPAB launched an AQI network to enable information sharing and support for current and future AQI users. The network allows CPAB to collect and share information about AQIs with the wider audit community. To join our AQI Network, or to learn more, contact AQINetwork@cpab-ccrc.ca.

We encourage audit committees, management and audit firms to use AQIs and share their experiences with the audit community. To receive advance notification of the launch of our new AQI publications and initiatives, please click [here](#).

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A TOOL FOR AUDIT COMMITTEES



**CENTER
FOR AUDIT
QUALITY**

**EXTERNAL
AUDITOR
ASSESSMENT
TOOL**

ABOUT THE CENTER FOR AUDIT QUALITY

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high-quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues that require action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

Please note that this publication is intended as general information and should not be relied upon as being definitive or all-inclusive. As with all other CAQ resources, this is not authoritative, and readers are urged to refer to relevant rules and standards. If legal advice or other expert assistance is required, the services of a competent professional should be sought. The CAQ makes no representations, warranties, or guarantees about, and assumes no responsibility for, the content or application of the material contained herein. The CAQ expressly disclaims all liability for any damages arising out of the use of, reference to, or reliance on this material. This publication does not represent an official position of the CAQ, its board, or its members.

EXTERNAL AUDITOR ASSESSMENT TOOL

INTRODUCTION

Among other important duties, audit committees of US public companies and registered investment companies have direct responsibility to oversee the integrity of a company's financial statements and to hire, compensate, and oversee the external auditor. There continues to be interest from investors, regulators, and others regarding how audit committees perform their responsibilities, including their oversight of the external auditor.

Audit committees should regularly (at least annually) evaluate the external auditor in fulfilling their duty in order to make an informed recommendation to the board whether to retain the external auditor. We are pleased to update this tool, which was last published in 2017, with additional questions related to firm-level audit quality considerations, including leadership, culture, engagement team management, audit engagement performance, and monitoring, among other topics. Our update also addresses (1) changes in accounting standards and (2) considerations regarding new and emerging risks.

Robust, two-way dialogue that includes providing constructive feedback to the external auditor may improve audit quality and enhance the relationship between the audit committee and the external auditor. The evaluation should encompass:

- + an assessment of the qualifications and performance of the external auditor;
- + the firm-level approach to promoting and monitoring audit quality;
- + the quality and candor of the external auditor's communications with the audit committee and the company; and
- + the external auditor's independence, objectivity, and professional skepticism.

To this end, the assessment questionnaire included in this tool can be used by audit committees to inform their evaluation of the external auditor. The term "external auditor" is intended broadly and comprises the lead audit engagement partner, the engagement team, and the audit firm. The

EXTERNAL AUDITOR ASSESSMENT TOOL

lead audit engagement partner¹ is responsible for proper supervision of the work of engagement team members and for compliance with Public Company Accounting Oversight Board (PCAOB) standards, including standards regarding using the work of specialists,² other auditors,³ internal auditors,⁴ and others who are involved in testing controls.^{5,6}

The sample questions highlight some of the more important areas for consideration; they are suggested for consideration and not intended to cover all areas that might be relevant to a particular audit committee's evaluation of its external auditor, nor do they suggest a "one-size-fits-all" approach. Moreover, this assessment tool is not meant to provide a summary of legal or regulatory requirements for audit committees or external auditors. An overview of portions of the relevant standards on required external auditor communications with the audit committee (appendix I) and sources of additional information on hiring and evaluating the external auditor (appendix II) are included at the end of this document. •

1 Throughout this publication, the term lead audit engagement partner is generally used to refer to the member of the engagement team with primary responsibility for the audit. AS 1201, *Supervision of the Audit Engagement*, uses the term engagement partner.

2 AS 1210, *Using the Work of a Specialist*.

3 AS 1205, *Part of the Audit Performed by Other Independent Auditors*.

4 AS 2605, *Consideration of the Internal Audit Function*.

5 Paragraphs .16-.19 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements*.

6 AS 1201.03.

ASSESSMENT PROCESS

The external auditor assessment should draw on the audit committee's experience with the external auditor during the current engagement (presentations, reports, and dialogue during formal meetings; ad hoc meetings; and executive sessions) and should be informed by prior-year evaluations, as applicable. Further, each assessment is more meaningful when informed by the risks the company faces and the external auditor's views regarding how management is addressing those risks. It is appropriate to obtain observations on the external auditor from others within the company, including management and internal audit, accompanied by discussions with other key managers. A suggested survey for obtaining observations from others within the company follows the assessment questionnaire. In evaluating information obtained from management, the audit committee should be sensitive to the need for the external auditor to be objective and skeptical while still maintaining an effective and open relationship with management. Accordingly, audit committees should be alert to whether management displays a strong preference for or a strong opposition to retaining the external auditor—and follow up as appropriate to understand the reasons.

Audit committee members can assess the external auditor throughout the audit process via both formal and informal assessments. Informal assessments can be made based on private meetings between the audit committee chair and the lead audit engagement partner, which can help build a constructive and mutually respectful working relationship. These contemporaneous assessments provide important input into the annual assessment. Audit committees may wish to consider those contemporaneous observations during a more formal assessment process, perhaps by using a questionnaire or guide, such as the one included in this tool. To ensure that multiple views are considered, audit committees may wish to finalize their assessment in group discussions (as opposed to collecting audit committee member comments separately) during formal committee meetings or conference calls.

Other sources of input into the audit committee's assessment of the external auditor may include discussions with the external auditor regarding its firm-level approach to promoting and monitoring audit quality, as well as information published by the firms that addresses audit quality issues (such

EXTERNAL AUDITOR ASSESSMENT TOOL

as firm transparency and audit quality reports), regulator inspection reports, and peer review findings, as applicable.

Finally, the audit committee should consider advising shareholders that it performs an annual evaluation of the external auditor. The audit committee also should consider explaining its process, scope of the assessment, and factors considered in selecting or recommending the audit firm or assessing its performance.⁷ •

⁷ *2018 Audit Committee Transparency Barometer*, an annual report issued jointly by the Center for Audit Quality and Audit Analytics. The Barometer provides year-over-year comparisons of key audit committee disclosure areas for companies of all sizes.

PART 1

QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE ENGAGEMENT TEAM

The audit committee's evaluation of the external auditor begins with considering the quality of the services provided by the engagement team during the audit and throughout the financial reporting year.

Because audit quality is highly dependent on the individuals who conduct the audit, the audit committee should assess whether the primary members of the engagement team demonstrated the knowledge, skills, and experience necessary to address the company's risks of material misstatement.⁸ The engagement team should have provided details regarding its risk assessment at the outset of the audit, including an assessment and discussion regarding fraud risks. During the engagement, the engagement team should have demonstrated a good understanding of the company's business, industry, and the impact of the economic environment on the company. Moreover, the engagement team should have

identified and responded to any significant auditing and accounting issues that arose from changes in the company or its industry, or changes in applicable accounting and auditing requirements.

Understanding the nature and extent of other accounting firm(s) participation in the audit in various domestic locations, or in other countries through the audit firm's global network or by other audit firms, allows the audit committee to monitor the quality of audit work in those jurisdictions.⁹ •

⁸ Such consideration includes the impact of any recently issued US generally accepted accounting principles (GAAP).

⁹ PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*, requires disclosure of the engagement partner name and the extent of participation of other accounting firm(s) on Form AP, which is filed with the PCAOB.

PART 1: QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE ENGAGEMENT TEAM

SAMPLE QUESTIONS	OBSERVATIONS
<p>Engagement team skill and responsiveness</p> <p>1</p> <ul style="list-style-type: none"> + Did the lead audit engagement partner and engagement team have the necessary knowledge, skills, and experience (company-specific, industry, accounting, auditing) to perform the audit of the company's financial statements? + Did the engagement team have sufficient access to specialized expertise during the audit? + Were additional and appropriate resources available to complete the audit timely and efficiently? + Was the lead audit engagement partner accessible to the audit committee and company management? + Did the lead audit engagement partner devote sufficient attention and leadership to the audit? + Did the external auditor seek feedback on the quality of the services provided? + How did the external auditor respond to feedback? 	
<p>Engagement team hours and workload</p> <p>2</p> <ul style="list-style-type: none"> + Did the lead audit engagement partner discuss trends in engagement hours and related timing such as: <ol style="list-style-type: none"> (1) total audit hours by various levels, including partner(s), manager(s), and staff (e.g., percentage of planned hours for the current year and actual audit hours for the prior year); (2) changes in audit hours from year to year (i.e., comparing the current year's planned hours with the prior year's actual hours); and (3) the breakdown of audit hours incurred by phase of the audit cycle, particularly the allocation for planning, execution, and completion? + Did the lead audit engagement partner discuss key engagement team members' workloads and workload information (compared to a standard workload by level as determined by the audit firm)? 	

PART 1: QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE ENGAGEMENT TEAM

SAMPLE QUESTIONS	OBSERVATIONS
<p>Audit plan and risks</p> <p>3</p> <ul style="list-style-type: none"> + Did the lead audit engagement partner discuss the audit plan, including the use of technology and how it addressed company- and industry-specific areas of accounting and audit risk (including fraud risk and other significant risks) with the audit committee? + Did the lead audit engagement partner identify the appropriate risks in planning the audit? + Did the external auditor use technology and analytics to identify risks? + Did the lead audit engagement partner discuss any risks of fraud in the financial statements that were factored into the audit plan? + Did the external auditor adjust the audit plan to respond to changing risks and circumstances? + Did the audit committee understand the changes in risk and agree that they were appropriate? 	
<p>Audit participants</p> <p>4</p> <ul style="list-style-type: none"> + If other accounting firm(s) participated in the audit in various domestic locations, or in other countries through the audit firm's global network or other audit firms, did the lead audit engagement partner provide information about the technical skills, experience, and professional objectivity of those external auditors? + Did the lead audit engagement partner explain how he or she reviews and supervises those other auditors, specialists, or personnel at shared service center(s), if applicable? + Did the lead audit engagement partner and/or engagement team provide information on significant interactions with other audit participants? 	
<p>Engagement team succession</p> <p>5</p> <ul style="list-style-type: none"> + If applicable, has the audit firm sufficiently explained how the changes or rotations of lead audit engagement partner or senior engagement team personnel would be managed? <i>(See part 4 for more questions related to compliance with independence rules.)</i> 	

PART 1: QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE ENGAGEMENT TEAM

SAMPLE QUESTIONS	OBSERVATIONS
<p>6</p> <p>Complex accounting and auditing matters, including consultations</p> <ul style="list-style-type: none"> + Did the lead audit engagement partner bring the resources of his or her firm to the audit and advise the audit committee of the results of any consultations with the audit firm's national professional practice office or other technical resources on accounting or auditing matters? + Were such consultations executed in a timely and transparent manner? + Were planned and actual allocation of resources associated with significant risks appropriate? 	
<p>7</p> <p>Scope and cost considerations</p> <ul style="list-style-type: none"> + Were the scope, hours, and cost of the audit reasonable and sufficient for the size, complexity, and risks of the company? + Were the reasons for any changes to scope, hours, and cost communicated to the audit committee? + Did the audit committee agree with the reasons? 	

PART 2

QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE AUDIT FIRM

Audit quality is broader than the engagement team. Important considerations for an audit committee include:

- + whether the audit firm has the relevant industry expertise, geographical reach, sufficient resources, appropriate specialists and/or national office resources necessary to continue to serve the company; and
- + the audit firm's system of quality control designed to deliver timely, efficient, effective audits in accordance with applicable professional standards.

A key part of the assessment process is the audit committee's understanding of how an audit firm promotes and monitors audit quality. The CAQ released its *Audit Quality Disclosure Framework* in January 2019. This voluntary Framework can help promote an important dialogue between audit firms and audit committees related to how audit quality is supported and monitored at the firm-level. The Framework provides illustrative Points of Focus

for the following six elements that are important to audit quality:

- (1) Leadership, Culture, and Firm Governance
- (2) Ethics and Independence
- (3) Acceptance and Continuance of Clients and Engagements
- (4) Engagement Team Management
- (5) Audit Engagement Performance
- (6) Monitoring

The Framework also includes example firm-level audit quality indicators (AQIs) and builds on prior work of the CAQ related to AQIs.¹⁰

Audit committees are encouraged to read a firm's audit quality report, if applicable, and use the Framework to assist in asking questions about a firm's approach to promoting and monitoring audit quality. •

¹⁰ CAQ's *Audit Quality Indicators: The Journey and Path Ahead* (January 2016) and *The CAQ Approach to Audit Quality Indicators* (April 2014).

ELEMENTS IMPORTANT TO AUDIT QUALITY

In its *Audit Quality Disclosure Framework*, the CAQ describes six elements important to audit quality:

Leadership, Culture, and Firm Governance. The firm's leadership sets the tone for the effectiveness of the firm's system of quality control and emphasizes the importance of audit quality and the auditor's role in providing trust in the capital markets. Together with firm leadership, the foundation of audit quality is the establishment of policies and procedures designed to promote an internal culture that recognizes that quality is essential in performing audit engagements. The composition of a firm's governing body and leadership structure give insight into who is responsible for oversight of audit quality initiatives.

Ethics and Independence. Ethics and independence are foundational qualities underlying the auditing profession. In recognition of this, professional standards require firms to establish policies and procedures to provide reasonable assurance that firm personnel maintain independence (in fact and in appearance) in all required circumstances, perform professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

Acceptance and Continuance of Clients and Engagements. Firms establish policies and procedures to determine whether the firm should accept or continue a client relationship or specific engagement. These policies are used

to assess whether the firm has the necessary capabilities and has appropriately considered associated risks, among other considerations.

Engagement Team Management. Engagement team management encompasses policies and procedures associated with recruitment, retention, and promotion; professional development; and assignment of engagement personnel and resources. These policies and procedures are designed to mobilize an engagement team that has the appropriate mix of knowledge, relevant experience by staff level and industry, and sufficient time to design and execute a quality audit under professional standards.

Audit Engagement Performance. Audit engagement performance encompasses processes such as the audit firm's audit methodology that guides the planning and performance of the audit; supervision and review, including engagement quality review; and communicating audit results. These processes help professionals perform audit procedures in accordance with the applicable professional standards.

Monitoring. Monitoring activities provide a firm with reasonable assurance that the policies and procedures relating to the system of quality control are suitably designed and are being effectively applied. Monitoring procedures may include such procedures as inspections and root-cause analyses. These processes are performed by qualified individuals who are not directly associated with the performance of the engagement. The nature and extent of monitoring procedures may vary given the nature and complexity of a firm's operations. •

PART 2: QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR – THE AUDIT FIRM

SAMPLE QUESTIONS	OBSERVATIONS
<p>8</p> <p>Audit quality report</p> <ul style="list-style-type: none"> + Does the firm's audit quality report, if applicable, provide transparency into how the audit firm promotes and monitors audit quality and how trends and disclosures are calculated? 	
<p>9</p> <p>Leadership, culture, and firm governance</p> <ul style="list-style-type: none"> + Does the audit firm's leadership, culture, and firm governance promote audit quality? + Do the firm's core values, principles, and code of conduct emphasize audit quality? 	
<p>10</p> <p>Engagement team management</p> <ul style="list-style-type: none"> + Does the audit firm have the necessary industry and specialized accounting and reporting expertise relevant to the company's primary operations? + Does the audit firm have the resources and geographical reach required to continue to serve the company? + Does the audit firm support effective engagement team performance through recruitment, retention, and promotion? + Does the audit firm's approach to professional development and coaching at both the firm and engagement team level promote audit quality? 	
<p>11</p> <p>Audit engagement performance</p> <ul style="list-style-type: none"> + Do audit firm policies reinforce planning and performing the audit to avoid surprises, promote early detection of issues, and achieve the timely completion of the audit? 	

PART 2: QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE EXTERNAL AUDITOR - THE AUDIT FIRM

SAMPLE QUESTIONS	OBSERVATIONS
<p>12</p> <p>Monitoring</p> <ul style="list-style-type: none"> + If the audit was subject to inspection by the PCAOB or other regulators—or other internal quality review—did the external auditor advise the audit committee in a timely manner of the selection of the audit findings, and the impact, if any, on the audit results? + Did the lead audit engagement partner communicate relevant results of the firm's inspection or internal quality review that may be pertinent to the company, such as themes and types of findings regarding companies in similar industries with similar accounting or audit issues? + Did the lead audit engagement partner explain the audit firm's root-cause analysis, if applicable, and remediation processes and how, as a result, the audit firm planned to respond to the inspection findings and to internal findings regarding its quality control program? 	

PART 3

COMMUNICATION AND INTERACTION WITH THE EXTERNAL AUDITOR

Frequent and open communication between the audit committee and the external auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the company's financial reporting process. The quality of communications also provides opportunities to assess the external auditor's performance. In addition to communicating with the audit committee as significant issues arise, the external auditor should also meet with the audit committee on a basis frequent enough to ensure the audit committee has a complete understanding of the stages of the audit cycle (e.g., planning, completion of final procedures, and, if applicable, completion of interim procedures). Such communications should focus on the key accounting or auditing issues that, in the external auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, as well as any questions or concerns of the audit committee. Audit committees should consider if implementation of new accounting standards is being adequately discussed by the company and the external auditor. Recent PCAOB rules provide for greater transparency to investors, media, and other stakeholders, and therefore the quality of

communication between the external auditor and the audit committee is increasingly important as audit committee members or management may be asked questions about the audit process.

PCAOB standards, Securities and Exchange Commission (SEC) rules, and stock exchange listing requirements identify a number of matters the external auditor is required to discuss with the audit committee. Audit committees should be familiar with those required communications and consider not only whether the external auditor met all the requirements, but, importantly, the level of openness and quality of these communications, whether held with management present or in executive session. •

PART 3: COMMUNICATION AND INTERACTION WITH THE EXTERNAL AUDITOR	
SAMPLE QUESTIONS	OBSERVATIONS
<p>13</p> <p>Openness of communications</p> <ul style="list-style-type: none"> + Did the lead audit engagement partner maintain a professional and open dialogue with the audit committee and audit committee chair? + Were discussions frank and complete? + Did the external auditor explain accounting and auditing issues in an understandable manner? 	
<p>14</p> <p>Nature of communications</p> <ul style="list-style-type: none"> + Did the external auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments? + Did the external auditor discuss how the company's accounting policies compare with industry trends and leading practices? + Did the external auditor discuss with the audit committee current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential impact on the audit? + Did the lead audit engagement partner explain the external auditor's responsibilities related to other information in documents containing audited financial statements, such as non-GAAP financial information?¹¹ + Did the external auditor discuss critical audit matters (CAMs) communicated in the auditor's report and how CAMs were identified?¹² 	

¹¹ AS 2701, Other Information in Documents Containing Audited Financial Statements.

¹² The CAQ released *Critical Audit Matters: Lessons Learned, Questions to Consider, and an Illustrative Example* in December 2018. This publication shares early observations from dry runs performed by certain firms, providing valuable perspective for audit committees, auditors, and others in the financial reporting ecosystem. In December 2017, the CAQ published *The Auditor's Report: Considerations for Audit Committees*, which explains key changes required by AS 3101 and lists key questions for audit committees to consider. See page 16 regarding effective dates.

PART 3: COMMUNICATION AND INTERACTION WITH THE EXTERNAL AUDITOR

SAMPLE QUESTIONS	OBSERVATIONS
<p>15</p> <p>Communication of concerns</p> <ul style="list-style-type: none"> + In executive sessions, did the external auditor discuss sensitive issues candidly and professionally, such as: <ul style="list-style-type: none"> • any concerns about management's reporting processes; • internal control over financial reporting (e.g., management review controls); or • the quality of the company's financial management team? + Did the lead audit engagement partner promptly alert the audit committee if he or she did not receive sufficient cooperation from management including management in other jurisdictions? 	

ACCOUNTING AND AUDITING DEVELOPMENTS AND POTENTIAL RISKS

1. Implementation of Recently Issued Accounting Standards

Calendar year-end public companies recently adopted the new revenue recognition and leases standards. The new credit losses standard is effective as of January 1, 2020, for calendar year-end public companies and is significant in scope.¹³ Audit committees should have a clear understanding of how management is assessing the impact of the new standard and forging a successful path to its implementation.

2. Recently Issued and Proposed PCAOB Standards

- + *Form AP*. PCAOB Rule 3211, Auditor Reporting of Certain Audit Participants (Form AP), requires the lead audit engagement partner name and participation of other accounting firm(s) to be publicly disclosed.
- + *Auditor's Reporting Model*. AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, includes significant changes to the current auditor's report, including the communication of CAMs. Communicating CAMs in audit reports is effective for large accelerated filers for periods ending on or after June 30, 2019, and for periods ending on or after December 15, 2020, for audits of all other companies to which the CAM requirements apply. Audit committees should discuss the impact of the implementation of this new auditing standard with their external auditor in advance of the effective date.
- + *Auditing Accounting Estimates, Including Fair Value Measurements and Using the Work of the Auditor-Engaged Specialist*. On December 20, 2018, the PCAOB Board adopted a new standard, AS 2501, *Auditing Accounting*

Estimates, Including Fair Value Measurements, and related amendments and amendments to the auditing standards regarding the requirements that apply when auditors use the work of specialists in an audit. Subject to the approval of the SEC, the new standard and related amendments will take effect for audits of financial statements for fiscal years ending on or after December 15, 2020.

3. Other Potential Risks

Although outside the scope of audits of the financial statements and internal control over financial reporting, audit committees also have, in many instances, been called on to understand other potential business and regulatory risks facing the company, such as:

- + *Non-GAAP Financial Information*. In recent years, the presentation of non-GAAP financial information has increased, and regulators and others have expressed concerns that investors could be misled or confused by this information, if it is not presented appropriately. Audit committees may wish to review the transparency, consistency, and comparability of their company's presentation of non-GAAP financial measures and other performance metrics.
- + *Cybersecurity*. Awareness continues to grow about evolving cybersecurity threats to companies. Understanding cybersecurity as an enterprise-wide risk management issue and considering the use of existing board resources, such as outside counsel and external auditors, may assist audit committees in gaining helpful perspectives on cyber-risk trends.
- + *Emerging Technologies*. Although emerging technologies present opportunities to increase efficiency and the quality of financial reporting, these opportunities are not risk-free. To inform their oversight activities related to management, audit committees should have discussions with their auditors about emerging technologies used in financial reporting.¹⁴

¹³ Accounting Standards Update No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

¹⁴ CAQ's *Emerging Technologies: An Oversight Tool for Audit Committees*.

PART 4

AUDITOR INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM

The external auditor must be independent of the issuer and—in the case of mutual funds—independent of the investment company complex. Audit committees should be familiar with the statutory and regulatory independence requirements for external auditors—including requirements that the external auditor advise the audit committee of any services or relationships that reasonably can be thought to bear on the audit firm's independence—and evaluate the external auditor in light of those requirements.

The technical competence of the external auditor alone is not sufficient to ensure a high-quality audit. The external auditor also must exercise a high level of objectivity and professional skepticism. The audit committee's interactions with the external auditor during the audit provide opportunities to evaluate whether the external auditor demonstrates integrity, objectivity, and professional skepticism. For example, the use of estimates and judgments in the financial statements and related disclosures (e.g., fair value, impairment) continues to be an important component of financial reporting.

The external auditor should be able to evaluate the methods and assumptions used by management to develop accounting estimates and to challenge those assumptions and application of accounting policies, including the completeness and transparency of the related disclosures as appropriate.

An important part of evaluating the external auditor's objectivity and professional skepticism is for the audit committee to gauge the frankness and informative nature of responses to open-ended questions asked of the lead audit engagement partner (and members of the engagement team as appropriate). Examples of appropriate topics include: the financial reporting challenges posed by the company's business model, the quality of the financial management team, the robustness of the internal control environment, changes in accounting methods or key assumptions underlying critical estimates, and the range of accounting issues discussed with management during the audit (including alternative accounting treatments in which the external auditor and management differed). The external auditor also should be able to clearly

EXTERNAL AUDITOR ASSESSMENT TOOL

articulate the processes followed and summarize the evidence used to evaluate management's significant estimates and judgments, and to form an opinion as to whether the financial statements, taken as a whole, were fairly presented in accordance with US GAAP. •

PART 4: AUDITOR INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM	
SAMPLE QUESTIONS	OBSERVATIONS
<p>16</p> <p>Independence compliance</p> <ul style="list-style-type: none"> + Did the external auditor report to the audit committee all matters that might reasonably be thought to bear on the audit firm's independence, including exceptions to its compliance with independence requirements? + Did the external auditor discuss processes in place to monitor and remediate independence violations? 	
<p>17</p> <p>Disagreements with management</p> <ul style="list-style-type: none"> + Were there any significant differences in views between management and the external auditor? + If so, did the external auditor present a clear point of view on accounting issues for which management's initial perspective differed? + Was the process of reconciling views achieved in a timely and professional manner? 	
<p>18</p> <p>Promotion of professional skepticism</p> <ul style="list-style-type: none"> + Did the external auditor promote the application of professional judgment and exercise of professional skepticism in executing the audit? 	

PART 4: AUDITOR INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM

SAMPLE QUESTIONS	OBSERVATIONS
<p>19</p> <p>Internal audit reliance</p> <ul style="list-style-type: none"> + If the external auditor is placing reliance on management and internal audit testing, did the audit committee agree with the extent of such reliance? + Were there any significant differences in views between the internal auditors and the external auditor? + If so, were they resolved in a professional manner? + Did the external auditor change or increase their testing due to internal audit findings, if applicable? 	
<p>20</p> <p>Non-audit services</p> <ul style="list-style-type: none"> + In obtaining pre-approval from the audit committee for all non-audit services, did the lead audit engagement partner discuss safeguards in place to protect the independence, objectivity, and professional skepticism of the external auditor? 	

SAMPLE FORM

OBTAINING INPUT FROM COMPANY PERSONNEL ABOUT THE EXTERNAL AUDITOR

Because you have substantial contact with the external auditor throughout the year, the audit committee is interested in your views on the quality of service provided, and the independence, objectivity, and professional skepticism demonstrated throughout the engagement by the external auditor and audit firm.

Please rate the external auditor's performance on each of the following attributes using the following five-point scale:

- 1 = Very Low/Completely Dissatisfied
- 5 = Very High/Completely Satisfied

QUALITY OF SERVICES PROVIDED BY THE EXTERNAL AUDITOR		RATING
1	Meets commitments (e.g., by meeting agreed-on performance delivery dates and being available and accessible to management and the audit committee).	
2	Is responsive and communicative (e.g., by soliciting input relative to business risks or issues that might impact the audit plan, identifying and resolving issues in a timely fashion, and adapting to changing risks quickly).	

QUALITY OF SERVICES PROVIDED BY THE EXTERNAL AUDITOR (CONTINUED)		RATING
3	Proactively identifies opportunities and risks (e.g., by anticipating and providing insights and approaches for potential business issues, bringing appropriate expertise to bear, and identifying meaningful alternatives and discussing their impacts).	
4	Delivers value for money (e.g., audit fees fairly reflect the cost of the services provided and the audit team is thoughtful about ways to achieve a cost-effective quality audit).	
5	Engages in periodic discussion regarding how the audit firm promotes and monitors audit quality.	
SUFFICIENCY OF AUDIT FIRM AND NETWORK RESOURCES		RATING
6	Is technically competent and able to translate knowledge into practice (e.g., by delivering quality services within the scope of the engagement, using technical knowledge and independent judgment to provide realistic analysis of issues, and providing appropriate levels of competence across the engagement team).	
7	Understands our business and our industry (e.g., demonstrating an understanding of our specific business risks, processes, systems, and operations; sharing relevant industry experience; and providing access to firm experts on industry and technical matters).	
8	Assigns sufficient resources to complete work in a timely manner (e.g., by providing an engagement team with the appropriate mix of experience, access to specialized expertise during the audit, and assigning additional resources to the audit as necessary to complete work in a timely manner).	
COMMUNICATION AND INTERACTION		RATING
9	Communicates effectively (e.g., by maintaining appropriate levels of contact/dialogue throughout the year, effectively communicating verbally and in writing, being constructive and respectful in all interactions, and providing timely and informative communications about accounting and other relevant developments).	

APPENDIX I

RELEVANT US REQUIREMENTS AND STANDARDS

PROHIBITED NON-AUDIT SERVICES

There are nine statutory categories of non-audit services that may not be provided to companies by the external auditors (Section 10A (g) to the Securities Exchange Act of 1934). For investment companies, these non-audit services may not be provided to any company in the investment company complex (as defined in 210.2-01(f)(14)):

- + Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- + Financial information systems design and implementation;
- + Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- + Actuarial services;
- + Internal audit outsourcing services;
- + Management functions or human resources;
- + Broker or dealer, investment adviser, or investment banking services;
- + Legal services and expert services unrelated to the audit; and
- + Any other service that the PCAOB determines, by regulation, is impermissible.

Audit committees must pre-approve the provision of all other non-audit services by the external auditor.

OVERVIEW OF EXTERNAL AUDITOR COMMUNICATIONS WITH AUDIT COMMITTEES

SEC Rule 2-07 requires the external auditor to communicate the following to the audit committee prior to the filing of the company's Form 10-K. For investment companies that file Form N-CSR, these communications must take place annually, except that if the annual communication takes place more than 90 days prior to the filing, the external auditor must provide an update describing any changes to the previously reported information.

- + Critical accounting policies and practices used by the issuer;
- + Alternative accounting treatments within US GAAP for accounting policies and practices related to material items that have been discussed with management during the current audit period, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the independent auditor;
- + Material written communications between the independent auditor and management of the issuer; and
- + If the audit client is an investment company, all non-audit services provided to any entity in the investment company complex that were not pre-approved by the investment company's audit committee pursuant to 210.2-01(c)(7).

AS 1301, *Communications with Audit Committees*, requires the following communications with the audit committee:

- + The independent auditor's responsibilities in relation to the audit under the standards of the PCAOB as part of establishing an understanding with the audit committee on the terms of the engagement, preferably through a written communication (i.e., engagement letter);
- + Communication of major issues discussed with management prior to the initial selection or retention as external auditors;
- + Whether the audit committee is aware of any matters relevant to the audit, particularly any violations of laws or regulations;

- + The overall audit strategy, timing of the audit and significant risks, including the participation of specialists, firms besides the principal auditor, or others involved in the audit;
- + The following with respect to the entity's accounting policies and practices, estimates and significant unusual transactions, and the external auditor's evaluation of the quality of a company's financial reporting:
 - Significant accounting policies and practices – Management's initial selection of, or changes in the current period; the effect on financial statements or disclosures for policies that are considered controversial, or where there is a lack of guidance or diversity in practice; and the external auditor's qualitative assessment of such policies and practices. Specifically, the quality, not just the acceptability, of the company's accounting principles as applied in its financial reporting and disclosures, including situations in which the external auditor identified bias in management's judgments and the external auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements which are individually reasonable, that indicate a possible bias on the part of company management;
 - Critical accounting policies and practices – The reasons such policies and practices are considered critical, how current and anticipated events could affect this determination, and the external auditor's assessment of related management disclosures;
 - Critical accounting estimates – A description of the process used to develop such estimates, management's significant assumptions in the estimates that have a high degree of subjectivity, any significant changes in management's process to develop an estimate, and the external auditor's conclusion as to the reasonableness of such estimates;
 - Significant unusual transactions – Significant transactions outside the normal course of business—or that are unusual due to timing, size, or nature—and the external auditor's understanding for the business rationale of such transactions;

- Financial statement presentation – The evaluation of whether the financial statements and related disclosures are presented fairly in accordance with the applicable financial reporting framework;
 - New accounting pronouncements – Any concern identified by the external auditor related to management's application of pronouncements that have been issued but are not yet effective in relation to future periods;
 - Alternative accounting treatments – All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the external auditor.
- + Other communications from the external auditor including the following:
- Other information – The external auditor's responsibility with respect to and results of audit procedures performed on other information accompanying the audited financial statements;
 - Difficult or contentious matters for which the external auditor consulted;
 - Management consultation with other accountants;
 - Going concern – (i) If the external auditor believes there is substantial doubt about the company's ability to continue as a going concern, including related events or conditions, (ii) substantial doubt has been alleviated due to management's plan, (iii) substantial doubt remains despite management's plans, and iv) the related effect on the financial statements and the auditor's report;
 - Corrected and uncorrected misstatements and omitted disclosures – Requires the external auditor to provide the audit committee with a written schedule of uncorrected misstatements that was provided to management. The standard also requires communication of: (i) the basis for the determination that uncorrected misstatements were immaterial, including qualitative assessment, (ii) uncorrected misstatements or underlying matters that could potentially cause future-period financial statements to be materially misstated, and (iii) corrected misstatements other than those deemed trivial, that might not have been detected other than through the audit procedures;
 - Disagreements with management, whether or not satisfactorily resolved that individually or in the aggregate could be significant to the entity's financial statements or the audit report;
 - Significant difficulties encountered with management in performing the audit.
- PCAOB standards** require the independent auditor to communicate all material weaknesses and significant deficiencies identified during the audit to the audit committee. If the independent auditor concludes that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, the external auditor is required to inform the board of directors.
- PCAOB rules** also require, at least annually, a written statement delineating all relationships between the independent auditor and the company, including individuals in financial reporting oversight roles at the company that reasonably can be thought to bear on independence.
- New York Stock Exchange Rule 303A.07(b)**, from its Listed Company Manual, requires audit committees to have a written charter that sets forth the committee's purpose, including, at a minimum, certain provisions of SEC Rule 10A-3(b) (2), (3), (4), and (5), as well as other specific duties and responsibilities, to assist board oversight of the integrity of the company's financial statements, and the independent auditor's qualifications, independence, and performance. Pertinent to external auditor oversight, the rule includes the following audit committee requirements:
- + Obtain and review at least annually a report by the independent auditor which describes (i) the firm's internal quality-control procedures, (ii) any material issues raised by the most recent internal quality-control review or peer review of the firm, or by any inquiry or investigation by governmental or professional authorities

EXTERNAL AUDITOR ASSESSMENT TOOL

within the preceding five years respecting one or more independent audits carried out by the firm (and any steps taken to deal with any such issues), and to assess the external auditor's independence, considering all relationships between the independent auditor and the listed company;

- + Meet to review and discuss the listed company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the listed company's (i) specific disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations," and (ii) policies with respect to risk assessment and risk management, the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;
- + Meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors;
- + Review with the independent auditor any audit problems or difficulties and management's response;
- + Set clear hiring policies for employees or former employees of the independent auditors; and
- + Report regularly to the board of directors.

Commentary to the rule pertinent to the assessment of the independent auditor further provides that after reviewing the external auditor's quality control report and the external auditor's work throughout the year, the audit committee will be in a position to evaluate the external auditor's qualifications, performance, and independence (including a review and evaluation of the lead audit engagement partner) taking into account the opinions of management and the company's internal auditors. The commentary further provides that, in addition to assuring the regular rotation of the lead audit engagement partner as required by law, the audit committee should consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. Finally, audit committees are instructed to present their conclusions to the full board of directors. •

APPENDIX II

RESOURCES AND SUGGESTED READING

BDO. *Effective Audit Committees for Nonprofit Organizations*. 2012.

Chartered Professional Accountants Canada. *Annual Assessment of the External Auditor: Tool for Audit Committees*. 2018.

Crowe LLP. *Corporate Governance for Public Companies: The Audit Committee*. 2019

Deloitte Center for Board Effectiveness. *Audit Committee Resource Guide*. 2018.

EY Center for Board Matters. *Staying on Course: A Guide for Audit Committees*. 2014.

Grant Thornton LLP. *Not-for-Profit Audit Committee Guidebook*. 2016.

KPMG Audit Committee Institute. *2017 Global Audit Committee Pulse Survey. Audit Committee Guide*. 2017.

New York Stock Exchange. *New York Stock Exchange Listed Company Manual*. 2019.

PwC. *Overseeing the External Auditors*. 2018.

RSM. *Audit Committee Guide for Financial Institutions*. 2015.

Related CAQ Resources

Audit Committee Collaboration. *Enhancing the Audit Committee Report: A Call to Action*. 2013.

Center for Audit Quality and Audit Analytics. *2018 Audit Committee Transparency Barometer*.

Center for Audit Quality. *Audit Quality Disclosure Framework*. 2019.

Center for Audit Quality. *Audit Quality Indicators: Journey and Path Ahead*. 2016.

Center for Audit Quality. *The CAQ Approach to Audit Quality Indicators*. 2014.

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