

# EXTERNAL AUDITOR ASSESSMENT TOOL

 A REFERENCE FOR AUDIT COMMITTEES WORLDWIDE

## INTRODUCTION

Among other important duties, audit committees of publicly listed companies generally have responsibility for overseeing the integrity of a company's financial statements and, in many jurisdictions, engaging and overseeing the external auditor.<sup>1</sup> Public focus on how audit committees discharge their responsibilities, including their oversight of the external auditor, has increased significantly.

A leading practice for audit committees is to regularly evaluate the external auditor in an effort to assess the quality of the audit, or select or recommend the retention of the audit firm.<sup>2</sup> The evaluation should encompass an assessment of the qualifications and performance of the auditor; the quality and candor of the auditor's communications with the audit committee and the company; and the auditor's independence, objectivity, and professional skepticism.

To this end, the assessment questionnaire included in this tool can be used by audit committees around the world to inform their evaluation of the auditor (i.e., the audit firm, as well as the lead audit partner, audit team, and engagement quality reviewer or similar concurring

reviewer role). The sample questions highlight some of the more important areas for consideration; they are not intended to cover all areas that might be relevant to a particular audit committee's evaluation of its 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 auditors, which vary around the globe or by jurisdiction. Helpful resources and suggested reading on audit committees are included in the Appendix.

## ASSESSMENT PROCESS

The auditor assessment should draw upon the audit committee's experience with the auditor during the current audit cycle (presentations; reports; dialogue during formal meetings, ad hoc meetings, and sessions without management present), and should be informed by prior-year evaluations, as applicable. It is appropriate to obtain observations on the 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 assessing information obtained from management, the audit committee should be sensitive to the need for the auditor to be objective and skeptical while still maintaining an effective and open relationship. Accordingly, audit committees should be alert to whether management displays a strong preference for or strong opposition to the auditor—and follow up as appropriate.

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<sup>1</sup>The term "audit committee(s)" includes those charged with oversight and governance of financial reporting, internal controls, and the audit, in recognition of diverse language and legal structures around the world. To the extent that some jurisdictions might use a different terminology to describe bodies that serve the same purpose, the term "audit committee(s)" would apply to those bodies as well.

<sup>2</sup>A leading practice for audit committees in most jurisdictions is to assess the auditor at least annually; in some jurisdictions, this is done as part of mandatory auditor retendering or rotation. However, some jurisdictions also recommend a more robust, comprehensive assessment every five years.



It makes good sense for audit committee members to continuously evaluate—through formal and informal assessments—the auditor’s performance throughout the audit process. Formal assessments can include an evaluation of the auditor’s skepticism in evaluating unusual transactions, responsiveness to issues, and, where applicable, the audit firm’s controls around the quality and performance of audit personnel across international locations. Informal assessments can be made based on private meetings between the audit committee chair and the lead audit partner, which can help build a constructive and mutually respectful working relationship between the audit committee and the auditor. These contemporaneous assessments can allow for 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 all views are consid-

ered, audit committees may wish to finalize their assessment during 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 include reviews of inspection reports from regulators and peer review findings. Audit committees also can request input from the audit firm itself on its performance through required or voluntary reporting as to how an audit firm’s management and operations support the performance of high quality audits.<sup>3</sup>

Finally, the audit committee should consider advising shareholders that they perform an annual evaluation of the auditor. The audit committee should also explain its process, the scope of the assessment, and the factors considered in selecting or recommending the audit firm, or assessing its performance.<sup>4</sup>

## QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE AUDITOR: PART I

The audit committee’s evaluation of the auditor often begins with an examination of the quality of the work provided by the audit team during the audit and throughout the financial reporting year. Because audit quality largely depends on the individuals who conduct the audit, the audit committee could assess whether the primary members of the audit team demonstrated the skills and experience necessary to address the company’s areas of greatest financial reporting risk and had access to appropriate specialists and/or resources in the audit firm that are responsible for audit quality, standards, and methodology, during the audit. The audit team typically provides a sound risk assessment at the outset of the audit, including an assessment of

fraud risk. During the audit, the auditor should have demonstrated a sound understanding of the company’s business, sector, and the impact of the economic environment on the company. Moreover, the auditor should have identified and responded to any auditing and accounting issues that arose from changes in the company or its sector, or changes in applicable accounting and auditing requirements. Another consideration for the audit committee is the quality of the audit teams that perform portions of the audit in other jurisdictions, or in other countries, by the audit firm’s global network or by other audit firms.

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<sup>3</sup> Some audit firms must produce reports to audit committees in response to securities exchange listing requirements (e.g., U.S. Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 16, *Communications with Audit Committees* or International Standard on Auditing (ISA) 260, *Communication with those Charged with Governance*). In addition, some firms must produce public reports to comply with disclosure requirements mandated by other jurisdictions (e.g., the European Union’s 8th Company Law Directive 2006/43/EC, Article 40 Transparency Report).

<sup>4</sup> Through *Enhancing the Audit Committee Report: A Call to Action*, the Audit Committee Collaboration encouraged public company audit committees to voluntarily and proactively improve their public disclosures to more effectively convey to investors and others the critical aspects of the important work that they currently perform, including the oversight of the external auditor. Please see the Appendix for more information on the *Call to Action* and other important resources.



SAMPLE QUESTION SETS	OBSERVATIONS
<p>1 Did the lead audit partner and audit team have the necessary knowledge and skills (company/sector-specific, accounting, auditing) to meet the company's audit requirements? Were the right resources dedicated to the audit? Did the auditor seek feedback on the quality of the services provided? How did the auditor respond to feedback? Was the lead audit partner accessible to the audit committee and company management? Did he/she devote sufficient attention and leadership to the audit?</p>	
<p>2 Did the lead audit partner discuss the audit plan and how it addressed company/sector-specific areas of accounting and audit risk (including fraud risk) with the audit committee? Did the lead audit partner identify the appropriate risks in planning the audit? Did the lead audit partner discuss any risks of fraud in the financial statement that were factored into the audit plan? Did the lead audit partner express his or her intent to perform detailed substantive testing?</p>	
<p>3 If portions of the audit were performed by other teams in other jurisdictions, or in other countries by the firm's global network or other audit firms, did the lead audit partner provide information about the technical skills, experience, and professional objectivity of those auditors? Did the lead audit partner explain how he/she exercises quality control and oversight over those auditors? Did the lead audit partner and/or team provide information on significant interactions between his/her team and those auditors?</p>	
<p>4 If applicable, has the audit firm sufficiently explained how the changes or rotations of lead audit partner or senior audit team personnel would be handled and managed (including maintaining independence and monitoring compliance with relevant requirements)? If the audit firm is rotating or changing, has the lead audit partner or senior audit team personnel provided additional insight into that change and explained how this transition would be handled and managed?</p>	
<p>5 During the audit, did the auditor meet the agreed-upon performance criteria as reflected in the engagement letter and audit plan? Did the auditor adjust the audit plan to respond to changing risks and circumstances? Did the audit committee understand the changes and agree that they were appropriate?</p>	
<p>6 Did the lead audit partner advise the audit committee of the results of consultations with the audit firm's office or leadership that is responsible for audit quality, standards, methodology or other technical resources on accounting or auditing matters? Were such consultations executed in a timely and transparent manner?</p>	



## QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE AUDITOR: PART II

Broader but nevertheless important considerations are (1) whether the audit firm has the relevant sector expertise, as well as the geographical reach necessary to continue to serve the company, and (2) whether the audit team effectively uses those resources. Other firm-wide questions include the results of the audit firm's most recent inspection report by its regulator(s), including

whether the company's audit had been inspected and, if so, whether the regulator(s) made comments on the quality or results of the audit. The audit committee also may want to know how the firm plans to respond to comments from the regulator(s) contained in the inspection report, more generally, and to any internal findings regarding the audit firm's quality control program.

SAMPLE QUESTION SETS	OBSERVATIONS
<p>7 If the company's audit was subject to inspection by regulators, did the auditor advise the audit committee of the selection of the audit, findings, and the impact, if any, on the audit results in a timely manner? Did the auditor communicate the results of the firm's inspection more generally, such as findings regarding companies in similar industries with similar accounting/audit issues that may be pertinent to the company? Did the auditor explain how the firm planned to respond to the inspection findings and to internal findings regarding its quality control program?</p>	
<p>8 Does the audit firm have the necessary sector experience, specialized expertise in the company's critical accounting policies, and geographical reach required to continue to serve the company?</p>	
<p>9 Did the audit team have sufficient access to specialized expertise during the audit? Were additional and appropriate resources made available as necessary to complete the audit work in a timely manner?</p>	
<p>10 Was the cost of the audit reasonable and sufficient for the size, complexity, and risks of the company? Were the reasons for any changes to cost (e.g., change in scope of work) communicated to the audit committee? Did the audit committee agree with the reasons?</p>	



## COMMUNICATION AND INTERACTION WITH THE AUDITOR

Frequent and open communication between the audit committee and the auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the company's financial reporting processes. The quality of communications also provides opportunities to assess the auditor's performance. In addition to communicating with the audit committee as significant issues arise, the auditor should also meet with the audit committee on a frequent enough basis 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 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.<sup>5</sup>

Regulators and stock exchange listing requirements may identify a number of matters the auditor must discuss with the audit committee. Audit committees should be familiar with those requirements and consider not only whether the auditor made all of the required communications, but, importantly, the level of openness and quality of these communications, whether held with management present or in private session.

SAMPLE QUESTION SETS	OBSERVATIONS
<p>11 Did the lead audit partner maintain a professional and open dialogue with the audit committee and audit committee chair? Were discussions frank and complete? Was the lead audit partner able to explain accounting and auditing issues in an understandable manner?</p>	
<p>12 Did the auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments? Did the auditor discuss how the company's accounting policies compare with sector trends and leading practices?</p>	
<p>13 In private sessions, did the auditor discuss sensitive issues candidly and professionally (e.g., his/ her views on, including any concerns about, management's reporting processes; internal control over financial reporting (e.g., internal ethics and compliance policies); the quality of the company's financial management team)? Did the lead audit partner promptly alert the audit committee if he/she did not receive sufficient cooperation?</p>	
<p>14 Did the auditor inform the audit committee of current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential impact on the audit?</p>	

<sup>5</sup> Some audit firms must follow specific guidance in producing reports to audit committees, including PCAOB Auditing Standard No. 16, *Communications with Audit Committees* and International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.



## AUDITOR INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM

Audit committees should be familiar with the statutory and regulatory independence requirements for auditors, including requirements that the auditor advise the audit committee of any services or relationships that reasonably can be thought to bear on the firm's independence, and evaluate the auditor in light of those requirements.

The technical competence of the auditor alone is not sufficient to ensure a high-quality audit. The auditor also must exercise a high level of objectivity and professional skepticism. The audit committee's interactions with the auditor during the audit provide opportunities to evaluate whether the 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 auditor must be able to evaluate the methods and assumptions used and to challenge, where necessary, management's assumptions and application of accounting policies, including the completeness and transparency of the related disclosures.

An important part of evaluating the auditor's objectivity and professional skepticism is for the audit committee to gauge the frankness and informative nature of responses to open-ended questions put to the lead audit partner (and members of the audit 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 where the auditor and management differed with respect to those treatments). The auditor also should be able to clearly articulate the processes followed and summarize the evidence used to evaluate management's significant estimates and judgments, and to form an opinion whether the financial statements, taken as a whole, were presented in accordance with the applicable financial reporting framework.

SAMPLE QUESTION SETS	OBSERVATIONS
<p>15 Did the audit firm 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 audit firm discuss safeguards in place to detect independence issues?</p>	
<p>16 Were there any significant differences in views between management and the auditor? If so, did the auditor present a clear point of view on accounting issues where management's initial perspective differed? Was the process of reconciling views achieved in a timely and professional manner?</p>	



SAMPLE QUESTION SETS	OBSERVATIONS
<p>17 If the 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 auditor? If so, were they resolved in a professional manner?</p>	
<p>18 In obtaining pre-approval from the audit committee for all non-audit services (where required by law or governance policies), did the lead audit partner discuss safeguards in place to protect the independence, objectivity, and professional skepticism of the auditor?</p>	



## 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 audit by the external audit team and firm.

Please rate the auditor's performance on each of the following attributes using a five-point scale, where **5 = Very High/Completely Satisfied** and **1 = Very Low/Completely Dissatisfied**.

QUALITY OF SERVICES PROVIDED BY THE EXTERNAL AUDITOR	RATING
1 Meets commitments (e.g., by meeting agreed upon performance delivery dates, 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).	
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 by identifying meaningful alternatives and discussing their impacts).	
4 Delivers value for money (e.g., by charging fees that fairly reflect the cost of the services provided, and being thoughtful about ways to achieve a cost-effective quality audit).	



SUFFICIENCY OF AUDIT FIRM AND NETWORK RESOURCES	RATING
<p>5 Is technically competent and able to translate knowledge into practice (e.g., by delivering quality services within the scope of the audit, using technical knowledge and independent judgment to provide realistic analysis of issues, and providing appropriate levels of competence across the team).</p>	
<p>6 Understands our business and our sector (e.g., by demonstrating an understanding of our specific business risks, processes, systems and operations, by sharing relevant sector experience, and by providing access to firm experts on sector and technical matters).</p>	
<p>7 Assigned sufficient resources to complete work in a timely manner (e.g., by providing access to specialized expertise during the audit and assigning additional resources to the audit as necessary to complete work in a timely manner).</p>	

COMMUNICATION AND INTERACTION	RATING
<p>8 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).</p>	
<p>9 Communicates about matters affecting the audit firm or its reputation (e.g., by advising us on significant matters pertaining to the audit firm while respecting the confidentiality of other clients' information, and complying with any professional standards and legal requirements, including informing us when the company's audit is subject to inspection by its regulator(s) and sharing the results of the review that are pertinent to the company's accounting or auditing issues).</p>	



INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM	RATING
<p>10 Demonstrates integrity and objectivity (e.g., by maintaining a respectful but questioning approach throughout the audit, proactively raising important issues to appropriate levels of the organization until resolution is reached, and articulating a point of view on issues).</p>	
<p>11 Demonstrates independence (e.g., by proactively discussing independence matters and reporting exceptions to its compliance with independence requirements).</p>	
<p>12 Is forthright in dealing with difficult situations (e.g., by proactively identifying, communicating and resolving technical issues, raising important issues to appropriate levels in the organization, and by handling sensitive issues constructively).</p>	

RECOMMENDATIONS

13 Are there actions the external auditor should take to improve its delivery of a quality audit?

Please sign, date, and return the form to \_\_\_\_\_ by \_\_\_\_\_ .

Questions may be directed to \_\_\_\_\_ . Thank you.

Signed \_\_\_\_\_ Title \_\_\_\_\_

Date \_\_\_\_\_



## APPENDIX: RESOURCES AND SUGGESTED READING

Deloitte & Touche LLP. *Audit Committee Resource Guide*. February 2015.

KPMG Audit Committee Institute. *2015 Global Audit Committee Survey*. 2015.

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

Audit Committee Guidance Committee. *Guidebook for Audit Committees in Singapore*. 2014.

National Association of Corporate Directors, Corporate Board Member/NYSE Euronext, Tapestry Networks, the Directors' Council, the Association of Audit Committee Members, Inc., and the Center for Audit Quality. *Enhancing the Audit Committee Report: A Call to Action*. 2013.

Frederick D Lipman, Barry H Genkin, Yelena M Barychev, Bureau of National Affairs (Arlington, Va.), Bloomberg BNA. *Audit Committees, Corporate Practice Series No. 49-6th*. 2013.

New York Stock Exchange. *New York Stock Exchange Listed Company Manual*. 2012.

Financial Reporting Council. *Guidance on Audit Committees*. September 2012.

Public Company Accounting Oversight Board. *Information for Audit Committees About the PCAOB's Inspection Process*. August 2012.

KPMG Audit Committee Institute. "Is Governance Keeping Pace?" 2012 Audit Committee Issues Conference Highlights. March 2012.

The Institute of Chartered Accountants in Australia, the Financial Reporting Council, and The Institute of Chartered Accountants of Scotland. *Walk the Line: Discussions and Insights With Leading Audit Committee Members*. February 2012.

European Confederation of Directors' Associations. *Audit Committee Guidance for European Companies*. 2011.

PwC LLP. *Audit Committee Effectiveness: What Works Best, 4th Edition*. Catherine L. Bromilow and Donald P. Keller. June 2011.

International Auditing and Assurance Standards Board (IAASB). *International Standard on Auditing (ISA) 260, Communication with those Charged with Governance*. 2010.

National Association of Corporate Directors and the Center for Board Leadership, KPMG LLP and Alliance Partners. *Report of the NACD Blue Ribbon Commission on Audit Committees*. October 2010.

Grant Thornton LLP. *The Audit Committee Handbook, Fifth Edition*. Louis Braiotta, Jr., R. Trent Gazzaway, Robert H. Colson and Sridhar Ramamoorthi. April 2010.

BDO USA LLP. *Effective Audit Committees in the Ever Changing Marketplace*. 2010.



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