



A TOOL FOR AUDIT COMMITTEES

CAQ
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.

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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

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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

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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 data-bbox="272 323 610 354">Communication of concerns</p> <p data-bbox="272 390 1068 453">+ In executive sessions, did the external auditor discuss sensitive issues candidly and professionally, such as:</p> <ul data-bbox="305 485 1040 674" style="list-style-type: none"> <li data-bbox="305 485 1008 516">• any concerns about management's reporting processes; <li data-bbox="305 548 1040 611">• internal control over financial reporting (e.g., management review controls); or <li data-bbox="305 642 1024 674">• the quality of the company's financial management team? <p data-bbox="272 705 1089 800">+ 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?</p>	

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

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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).	

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COMMUNICATION AND INTERACTION (CONTINUED)		RATING
10	Communicates about matters affecting the external auditor or its reputation (e.g., by advising us on significant matters pertaining to the external auditor while respecting the confidentiality of other clients' information, and complying with professional standards and legal requirements, including informing us when the audit is subject to inspection by the PCAOB or other regulatory review and sharing the results of the review that are pertinent to the company's accounting or auditing issues).	
INDEPENDENCE, OBJECTIVITY, AND PROFESSIONAL SKEPTICISM		RATING
11	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).	
12	Demonstrates independence (e.g., by proactively discussing independence matters and reporting exceptions to its compliance with independence requirements).	
13	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 handling sensitive issues constructively).	

RECOMMENDATIONS

Should the external auditor take any actions to improve its delivery of a quality audit?

Please sign, date, and return the form to _____

by _____. Questions may be directed to _____. Thank you.

Signature

Title

Date

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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