Quality of services and sufficiency of resources provided by the auditor

The audit committee’s evaluation of the auditor begins with an examination of the quality of the services provided by the engagement 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 should assess whether the primary members of the audit engagement team demonstrated the skills and experience necessary to address the company’s areas of greatest financial reporting risk and determine if they had access to appropriate specialists or national office resources during the audit. The engagement team should have provided a sound risk assessment at the outset of the audit, including an assessment of fraud risk.

During the engagement, the auditor should have demonstrated a good understanding of the company’s business, its industry and the effect of the current 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 industry, or changes in applicable accounting and auditing requirements. Another consideration for the audit committee is the quality of the engagement teams that perform portions of the audit in various domestic locations or abroad by the firm’s global network or other audit firms.

Sample questions

- Did the lead engagement partner and audit team have the necessary knowledge and skills (company-specific, industry, 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 engagement partner accessible to the audit committee and company management? Did he or she devote sufficient attention and leadership to the audit?

- Did the lead engagement partner discuss the audit plan and how it addressed company- and industry-specific areas of accounting and audit risk (including fraud risk) with the audit committee? Did the lead engagement partner identify the appropriate risks in planning the audit? Did the lead engagement partner discuss any risks of fraud in the financial statement that were factored into the audit plan?
If portions of the audit were performed by other teams in various domestic locations, or abroad by the firm’s global network or other audit firms, did the lead engagement partner provide information about the technical skills, experience and professional objectivity of those auditors? Did the lead engagement partner explain how he or she exercises quality control over those auditors?

During the audit, did the auditor meet the agreed-upon performance criteria, such as the engagement letter and audit scope? 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?

Did the lead engagement partner advise the audit committee of the results of consultations with the firm’s national office technical partners or other technical resources on accounting or auditing matters? Were such consultations executed in a timely and transparent manner?

A broader but important consideration is whether the audit firm has the relevant industry knowledge, as well as the geographical reach necessary to continue to serve the company, and whether the engagement team effectively uses those resources. Other questions involve the results of the audit firm’s most recent inspection report by the PCAOB, including whether the company’s audit had been inspected, and if so, whether the PCAOB made comments on the audit’s quality or results. The audit committee also may want to know, in general, how the firm plans to respond to the PCAOB comments and to any internal findings regarding its quality control program.

Sample questions

- If the company’s audit was subject to inspection by the PCAOB or other regulators, did the auditor advise the audit committee of the selection of the audit, the findings and the effect, 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 or 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?

- Was the cost of the audit reasonable and sufficient for the company’s size, complexity and risks? 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?

- Does the audit firm have the necessary industry experience, specialized expertise in the company’s critical accounting policies and geographical reach required to continue to serve the company?

- How did the audit team respond to turnover on the engagement team? Were individuals with the appropriate skills and knowledge assigned to complete the audit?

- Did the audit engagement team have sufficient access to specialized expertise during the audit? Were additional resources dedicated to the audit as necessary to complete work in a timely manner?

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. While the auditor should communicate with the audit committee as significant issues arise, the auditor ordinarily should meet with the audit committee on a frequent enough basis to make sure 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.

PCAOB standards, SEC rules and exchange listing requirements 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 executive sessions.

Sample questions

- Did the audit engagement partner maintain a professional and open dialogue with the audit committee and audit committee chair? Were discussions frank and complete? Was the audit engagement partner able to explain accounting and auditing issues in an understandable manner?

- 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 industry trends and leading practices?

- In executive sessions, did the auditor discuss sensitive issues candidly and professionally (e.g., his or her views on, including any concerns about, management’s reporting processes; internal control over financial reporting, such as a whistle-blower policy; the quality of the company’s financial management team)? Did the audit engagement partner promptly alert the audit committee if he or she did not receive sufficient cooperation?
• Did the auditor make sure that the audit committee was informed of current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential effect on the audit?

Auditor independence, objectivity and professional skepticism

The 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 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.

The auditor's technical competence alone is not sufficient to deliver a high-quality audit. The auditor also must exercise a high level of objectivity and professional skepticism. The auditor's interactions with the audit committee during the audit provide a number of opportunities to evaluate whether the auditor demonstrated 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 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 engagement partner (and members of the audit 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 and the treatment preferred by the auditor). The auditor also should be able to clearly articulate the processes followed and summarize the evidence used to evaluate the significant estimates and judgments, and the auditor should be able to form an opinion on whether the financial statements, taken as a whole, were fairly presented in accordance with GAAP.

Sample questions

• Did the audit firm report to the audit committee all matters that might reasonably be thought to bear on the firm's independence, including exceptions to its compliance with independence requirements? Did the audit firm discuss safeguards in place to detect independence issues?

• 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?

• If the auditor is relying 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 professionally?

• In obtaining preapproval from the audit committee for all non-audit services, did the lead engagement partner discuss safeguards in place to protect the independence, objectivity and professional skepticism of the auditor?

• Does the audit firm have a succession plan for all partners subject to rotation?