A REFERENCE FOR US AUDIT COMMITTEES

EXTERNAL AUDITOR ASSESSMENT TOOL

CENTER FOR AUDIT QUALITY

APRIL 2017

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 to make an informed recommendation to the board whether to retain the external auditor. Further, 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 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 (i.e., the audit firm and its system of quality control, as well as the lead audit engagement partner, audit team members, other accounting firm(s) participating in the audit, the engagement quality reviewer, specialists, and national office resources, if applicable). 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 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.

AUDIT QUALITY INDICATORS

Since initially publishing the *External Auditor Assessment Tool* in October 2012, the Center for Audit Quality (CAQ) has developed perspectives regarding which quantitative indicators of audit quality may be most relevant and how and to whom they should be communicated. The CAQ's report, *Audit Quality Indicators: Journey and Path Ahead*, offers indicators grounded in four thematic elements of audit quality: firm leadership and tone at the top; engagement team knowledge, experience, and workload; monitoring; and auditor reporting. This tool has been updated to reflect these thematic elements.

The conversation related to audit quality indicators is most impactful in driving actions that improve or maintain audit quality when audit committees have the flexibility to tailor the discussion around the facts and circumstances of their particular audit. The potential components, or indicators, of audit quality, detailed in the CAQ's report, can support or be used to initiate these conversations about auditor performance, but by themselves do not lead to a holistic understanding of audit quality.

Assessment Process

The external auditor assessment should draw upon 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 must be 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. Accordingly, audit committees should be alert to whether management displays a strong preference for or a strong opposition to the external auditor—and follow up as appropriate.

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 between the audit committee and the external auditor. 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 all views are considered, 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 regulator inspection reports and peer review findings. Audit committees can also request input from the audit firm itself on its performance through reporting as to how an audit firm's management and operations support the performance of high quality audits.

Finally, the audit committee should consider advising shareholders that they perform an annual evaluation of the external auditor. The audit committee should also explain its process, scope of the assessment, and factors considered in selecting or recommending the audit firm, or assessing its performance.[1, 2]

1 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. See Appendix II for more information on the *Call to Action* and other important resources.

2 See *2016 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 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 knowledge, skills, and experience necessary to address the company's risks of material misstatement and had access to appropriate specialists and/or national office resources during the audit. This will also need to encompass the impact of new US Generally Accepted Accounting Principles (GAAP) related to revenue recognition, leases, and accounting for credit losses recently issued.[3] The engagement team should have provided details regarding its risk assessment at the outset of the audit, including an assessment of fraud risk. During the engagement, the external auditor should have demonstrated a good understanding of the company's business, industry, and the impact of the economic environment on the company. Moreover, the external auditor 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. Although outside the scope of audits of the financial statements and internal control over financial reporting (ICFR), the audit committee also has, in many instances, been called upon to understand other potential risks facing the company, such as a company's use of non-GAAP financial information and cybersecurity risk management.

Understanding what other accounting firm(s) participate 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. Audit committees may need to consider (1) that the engagement partner name is now publicly disclosed by audit firms on Form AP and (2) that the extent of participation of other accounting firm(s) is required to be publicly disclosed on Form AP for audit reports issued on or after June 30, 2017 as a result of a new Public Company Accounting Oversight Board (PCAOB) rule.[4]

	SAMPLE QUESTION SETS	OBSERVATIONS
1	Did the lead audit engagement partner and audit team have the necessary knowledge, skills, and experience (company-specific, industry, accounting, auditing) to perform the company's audit? Were the right resources dedicated to the audit (years of experience with the firm, years at present level, years on the engagement)? Did the external auditor seek feedback on the quality of the services provided? How did the external auditor respond to feedback? Was the lead audit engagement partner accessible to the audit committee and company management? Did he/she devote sufficient attention and leadership to the audit?	

3 For calendar year-end public companies, Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) is effective January 1, 2018. ASU 2016-02, *Leases* (Topic 842) is effective January 1, 2019 and ASU 2016-13, *Financial Instruments – Credit Losses* (Topic 326) is effective January 1, 2020.

4 PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.

SAMPLE QUESTION SETS		OBSERVATIONS
2	Did the lead audit engagement partner discuss trends in engagement hours and related timing? For example, trends discussed may include: (1) total audit hours by various levels, including partner(s), manager(s), and staff (e.g., percentage of planned hours for current year and actual audit hours for prior year); (2) changes in audit hours from year to year (i.e., comparing current year planned hours to prior year actual hours); and (3) the breakdown of audit hours incurred by phase of the audit cycle, particularly the allocation between 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 (determined by the audit firm)?	
3	Did the lead audit engagement partner discuss the audit plan and how it addressed company/industry-specific areas of accounting and audit risk (including fraud risk) with the audit committee? Did the lead audit engagement partner identify the appropriate risks in planning the audit? Did the lead audit engagement partner discuss any risks of fraud in the financial statement that were factored into the audit plan?	
4	If other accounting firm(s) participate 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/she reviews and supervises those other auditors? Did the lead audit engagement partner and/or team provide information on significant interactions between his/her team and those other auditors?	
5	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 handled and managed (including maintaining independence and monitoring compliance with relevant requirements)?	
6	During the audit, did the lead audit engagement partner meet the agreed-upon performance criteria as reflected in the engagement letter and audit scope? Did the external 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?	

SAMPLE QUESTION SETS		OBSERVATIONS
7	Did the lead audit engagement partner bring the "firm to the company," advising 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?	

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, and important considerations for an audit committee are (1) whether the audit firm has the relevant industry expertise, as well as the geographical reach necessary, to continue to serve the company, and (2) whether the engagement team effectively utilizes those resources. In addition, the audit committee should evaluate the audit firm's system of quality control, including training and tone-at-the top, all of which contribute to audit quality.

Other firm-wide questions include 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 provided comments on the quality or results of the audit. The audit committee also may want to know how the firm plans to respond to PCAOB comments contained in the inspection report, more generally, and to any internal quality review, peer review, or other internal findings regarding the audit firm's quality control program.

SAMPLE QUESTION SETS		OBSERVATIONS
8	If the company's audit was subject to inspection by the PCAOB or other regulators, or other internal quality review, did the external 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 lead audit engagement partner communicate relevant results of the firm's inspection or internal quality review, such as findings regarding companies in similar industries with similar accounting/audit issues that may be pertinent to the company? Did the external auditor explain how the firm planned to respond to the inspection findings and to internal findings regarding its quality control program? Did the lead audit engagement partner provide an overview of how the audit firm's leadership, through its tone at the top, emphasizes audit quality and holds itself accountable for the audit firm's system of quality control?	

SAMPLE QUESTION SETS		OBSERVATIONS
9	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?	
10	Did the audit engagement team have sufficient access to specialized expertise during the audit? Were additional and appropriate resources dedicated to the audit as necessary to complete the audit work in a timely manner?	
11	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?	

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 processes. 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 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 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 are being adequately discussed by the company and the external auditor. As new PCAOB rules provide for greater transparency to investors, media, and other stakeholders, 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, SEC rules, and stock exchange listing requirements identify a number of matters the external auditor must 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.

SAMPLE QUESTION SETS		OBSERVATIONS
12	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? Was the lead audit engagement partner able to explain accounting and auditing issues in an understandable manner?	
13	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 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?[5]	
14	In executive sessions, did the external auditor discuss sensitive issues candidly and professionally (e.g., his/her views on, including any concerns about, management's reporting processes); ICFR (e.g., internal whistleblower policy); the quality of the company's financial management team)? Did the lead audit engagement partner promptly alert the audit committee if he/she did not receive sufficient cooperation?	
15	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?	

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 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 achieve a high-quality audit. The external auditor also must exercise a high level of objectivity

5 See, PCAOB AS 2701, *Other Information in Documents Containing Audited Financial Statements*.

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 must be able to evaluate the methods and assumptions used and to challenge management's assumptions and application of accounting policies, including the completeness and transparency of the related disclosures.

An important part of evaluating the external auditor's objectivity and professional skepticism is for the audit

RECENT CONSIDERATIONS FOR DISCUSSION

1 Implementation of New GAAP – Revenue Recognition, Leases, CECL

- The new revenue recognition standard is historic in its breadth and impact across industries. Audit committees should have a clear understanding of how management is assessing the impact of the new revenue recognition standard and forging a successful path to its implementation. The effective date of the new standard for calendar year-end public companies is January 1, 2018 (annual reporting periods beginning after December 15, 2017, and interim reporting periods therein). The new Leases and Current Expected Credit Losses (CECL) standards are also significant in scope and are effective as of January 1, 2019 and 2020, respectively, for calendar-year end public companies.

2 New and Proposed PCAOB Standards

- Form AP. PCAOB Rule 3211, Auditor Reporting of Certain Audit Participants (Form AP) requires the engagement partner name to be publicly disclosed for auditors' reports issued on or after January 31, 2017. Information about participation of other accounting firm(s) is required to be publicly disclosed for auditors' reports issued on or after June 30, 2017.

- Auditor's Reporting Model. The re-proposed PCAOB standard, Auditor's Reporting Model, includes significant changes to the current auditors' report, including new disclosures of critical audit matters.

3 Other Risks

Although outside the scope of audits of the financial statements and ICFR, the audit committee also has, in many instances, been called upon to understand other potential risks facing the company, such as:

- Non-GAAP financial information. In recent years, the presentation of non-GAAP financial measures 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 measures.

- Cybersecurity. Awareness continues to grow around the 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.

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 where the external auditor and management differed with respect to those treatments). The external 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 fairly presented in accordance with US GAAP.

	SAMPLE QUESTION SETS	OBSERVATIONS
16	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?	
17	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 where management's initial perspective differed? Was the process of reconciling views achieved in a timely and professional manner?	
18	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 audit firm? 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?	
19	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 audit team and firm.

Please rate the external 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 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).	
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., 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).	

	SUFFICIENCY OF AUDIT FIRM AND NETWORK RESOURCES	RATING
5	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 team).	
6	Understands our business and our industry (e.g., by demonstrating an understanding of our specific business risks, processes, systems and operations; by sharing relevant industry experience; and by providing access to firm experts on industry and technical matters).	
7	Assigned 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
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).	
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 professional standards and legal requirements, including informing us when the company's 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
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).	
11	Demonstrates independence (e.g., by proactively discussing independence matters and reporting exceptions to its compliance with independence requirements).	
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).	

RECOMMENDATIONS

13 Are there actions the external auditor should take to improve its delivery of a quality audit? How does the audit firm use data analytics and other technology in the performance of the 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 an investment company complex that were not pre-approved by the investment company's audit committee pursuant to 210.2-01(c)(7).

PCAOB Auditing Standard 1301 (AS 1301),
Communications with Audit Committees

The standard 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). The standard also requires communication of major issues discussed with management prior to the initial selection or retention as auditors;
- Whether the audit committee is aware of any matters relevant to the audit, particularly any violations of laws or regulations. The standard also requires the external auditor to communicate the overall audit strategy, timing of the audit and significant risks, including the participation of specialists, firms besides the principal auditor, or others in the audit; and
- 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; and
- 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 include:

- 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 – Whether the external auditor believes there is: (i) substantial doubt 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) related effect on the financial statements;
- 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 for the basis of whether: (i) uncorrected misstatements were immaterial, including qualitative assessment, (ii) uncorrected misstatements or underlying matters 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; and
- 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 an annual 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 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 (iii) to assess the external auditor's independence, 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 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 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

Deloitte & Touche LLP. *Audit Committee Resource Guide*. 2015.
EY Center for Board Matters. *Our Commitment to Audit Quality*. 2016.
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*. 2017.
KPMG Audit Committee Institute. *Audit Committee Guide*. 2016.
New York Stock Exchange. *New York Stock Exchange Listed Company Manual*. 2017.
PwC. *Audit Committee Excellence Series*. 2017
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. *2016 Audit Committee Transparency Barometer*. 2016.
Center for Audit Quality. *Audit Quality Indicators: Journey and Path Ahead*. 2016.
Center for Audit Quality. *The CAQ Approach to Audit Quality Indicators*. 2014.

ABOUT THE AUDIT COMMITTEE COLLABORATION

The *External Auditor Assessment Tool* was originally developed in 2012 by the Audit Committee Collaboration. The Audit Committee Collaboration is a partnership of nationally recognized US corporate governance and policy organizations that work together to expand audit committee members' access to useful tools and materials with the goal of strengthening audit committee performance and transparency.

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 requiring 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.

WE WELCOME YOUR FEEDBACK Please send comments or questions to info@thecaq.org.