

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



Appraising Your Auditors

A Guide to the
Assessment and
Appointment of
Auditors

A practical guide from
The Institute of Chartered
Accountants of Scotland

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



Appraising Your Auditors

A Guide to the Assessment and Appointment of Auditors

A Practical Guide
from
The Institute of Chartered Accountants of Scotland

FIRST EDITION PUBLISHED IN JUNE 2003
SECOND EDITION PUBLISHED IN OCTOBER 2007

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND

© 2007

ISBN 978-1-904574-40-8
EAN 9781904574408

This document is published by the Technical Policy Board of The Institute of Chartered Accountants of Scotland. The views expressed in this publication are those of the Working Party and do not necessarily represent the views of the Council of The Institute.

This document gives general guidance only and should not be relied upon as appropriate or comprehensive in respect of any particular set of circumstances. It is recommended that users take specific advice from their own professional advisor.

No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the authors or the publisher.

All rights reserved. This publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, with appropriate acknowledgement of the publisher.

This booklet can be downloaded without charge from the Institute's website at:
www.icas.org.uk

A hard copy can be obtained on request from:
The Institute of Chartered Accountants of Scotland
21 Haymarket Yards, Edinburgh EH12 5BH
Tel: 0131 347 0240
Fax: 0131 347 0110
E-mail: accountingandauditing@icas.org.uk

Acknowledgements

The Institute's Technical Policy Board would like to thank

Ian Paterson Brown
Chief Operating Officer
Resolution Asset Management

Alan Thomson
Chairman of the Audit Committee
Johnson Matthey Plc
Chairman of the Technical Policy Board
The Institute of Chartered Accountants of Scotland

Charlotte Barbour
Assistant Director, Accounting and Auditing
The Institute of Chartered Accountants of Scotland

for reviewing and updating the guidance in this edition. The Board should also like to thank the members of the Working Party who took part in this initiative in 2003.

The members and their positions at the time of writing the first edition were:

Ian Paterson Brown (Chairman)
Finance Director
ISIS Asset Management plc

Bryan Rankin
Finance Director
Caledonian Trust plc

Alan Thomson
Finance Director
Smiths Group plc

Andrew Walker
Senior Technical Manager
PKF

David Wood
Deputy Director, Accounting and Auditing
Secretary to the Business Law Committee
The Institute of Chartered Accountants of Scotland

It should be noted that the above individuals were acting in their personal capacity and were not representing the organisations for which they work.

Any enquiries should be addressed in the first instance to
Charlotte Barbour, Assistant Director, Accounting and Auditing,
The Institute of Chartered Accountants of Scotland
21 Haymarket Yards
Edinburgh
EH12 5BH
E-mail: cbarbour@icas.org.uk

Appraising Your Auditors

A Guide to the Assessment and Appointment of Auditors

Contents

	<u>Page</u>
Foreword	7
Introduction	9
• Introduction to the Checklists	9
• Auditor Independence	10
• Company – Auditor Relationship	10
• The Tender Process	11
• Practical Approach – How to use this Guide	11
• Conclusion	12
Flowchart: Auditor Assessment	13
Audit Committee Guidance Questions - Possible Trigger Points from Ongoing Auditor Review	15
Audit Committee Guidance Questions - Annual Audit Assessment	19
Audit Committee Guidance Questions - Selection and Appointment of New Audit Firm	25

Appraising Your Auditors

A Guide to the Assessment and Appointment of Auditors

FOREWORD

by **Sir Robert Smith**

Chairman of The Weir Group plc,
Chairman of Scottish and Southern Energy plc,
Chairman of the Group appointed by the Financial Reporting Council
to develop Guidance for Audit Committees, and
Past-President of The Institute of Chartered Accountants of Scotland

I am pleased to support the second edition of this publication by The Institute of Chartered Accountants of Scotland. It has addressed the much written about and much discussed issues of auditor independence and objectivity and the role of the audit committee from a very practical standpoint, and adds to the ongoing debate on the subject.

The practical aspects of this publication, which is aimed at providing audit committees with detailed assistance in evaluating the audit issues, are contained in the flow diagram and the detailed guidance questions which are split into three helpful checklists. These checklists, or sets of guidance questions, have been well received and widely used by audit committees in implementing the guidance developed by the FRC appointed group which I chaired and which was published in January 2003.

The guidance questions are drawn up as three specific checklists:

- 1) Trigger points from the audit committee's ongoing review of the auditors, which may indicate that an assessment of the auditors should be undertaken;
- 2) Points to consider in a full annual assessment of the auditors; and
- 3) Procedural matters for addressing during the audit tender process.

However, their purpose is very much aimed at creating practical guidance and direction for audit committees seeking to discharge their duties. To treat these checklists as another tick box exercise will neither meet the requirements of demonstrating that the audit committee has discharged its duties, nor do credit to the significant work in preparing this practical guidance.

As audit committees are being given additional responsibilities and are being required to perform an even more critical role in the relationship between company and external auditor, the guidance should provide assistance to them in performing this very important duty. Furthermore, in highlighting factors which might be relevant to the audit committee's consideration of the audit relationship, this publication should create a catalyst for rigorous discussion and debate. It should also help develop the audit trail for audit committees by establishing the validity, effectiveness and professionalism with which they discharge their obligations of assessing auditor independence and objectivity.

Sir Robert Smith
October 2007

Introduction

Introduction to the Checklists

The Institute of Chartered Accountants of Scotland is pleased to publish this short paper, and hopes that the guidance questions set out in the appendices will be of assistance to audit committees in the application of best practice and, in particular, in following the Combined Code guidance developed by the FRC-appointed group chaired by Sir Robert Smith.

While the guidance questions have been prepared in the form of three user friendly checklists, which should provide practical guidance for audit committees, they are not intended to create a “tick box” exercise. It is anticipated that, used sensibly, they will stimulate questioning and debate. If they are to provide an audit trail, they should be accompanied by suitable supporting documentation.

We have deliberately avoided the development of large sections of text, in order not to duplicate material in the Combined Code guidance or in guidance available from numerous other sources. Instead, we have sought to provide a flowchart and three practical checklists which can be readily used by company audit committees in managing and reviewing their relationship with their auditors. The three checklists cover:

- Trigger points from the audit committee’s ongoing review of the auditors, which may indicate that an assessment of the auditors should be undertaken;
- Points to consider in a full annual assessment of the auditors; and
- Procedural matters for addressing during the audit tender process.

The guidance questions are designed to highlight the issues which should be considered by the audit committee when monitoring its auditors and formally reviewing them prior to recommending re-appointment and, where necessary, provide assistance on the audit tender process. They might form part of the documentary evidence of the work of the audit committee. The questions could also be of use to others in the company, to professional firms with an interest in the audit process, and other parties.

Although designed to reflect the Combined Code guidance for audit committees developed by Sir Robert Smith’s group, the guidance questions also reflect our own views on matters of best practice and, to that extent, we hope they make a useful contribution to the ongoing debate on the role of audit committees in the framework of corporate governance.

The checklists are intended as a means of bringing rigour to the matters to be considered by audit committees and to the judgements which need to be made. We are not advocating that a “tick box” mentality be adopted by audit committees, but instead emphasise that judgement must be applied in relation to each question raised. By definition, this will require a joined up approach between management, internal assurance functions including the company secretary, the external auditors and the audit committee.

Whilst these guidance questions are designed to be applicable to the largest of listed groups, it is hoped that they will also be of assistance to other, smaller, listed and unlisted companies and groups, whether or not they have a formal audit committee, and indeed in any company where the management is separated from the ownership. Accordingly, the term “audit committee” in the following text and in the questions should be taken to mean “audit committee or other appropriate persons”.

In addition to explaining about guidance questions, this introduction seeks to raise some issues which should be considered and debated by audit committees - relating to auditor independence, the company - auditor relationship and the tender process. We have not sought to replicate what has already been written on these subjects from a technical or guidance standpoint. Rather, we have preferred to raise a few practical issues which are worthy of debate and which should provide some background information to the audit committee on the professional framework against which the checklists or guidance questions can be implemented.

Auditor Independence

In today's business climate, boards and audit committees must not lose sight of the need, not only to ensure independence, objectivity and effectiveness of auditors, but also to be able to demonstrate that they have done so. In order to secure the primary objective of auditor objectivity, there are various provisions relating to independence which auditors are required to follow. For the audit committee, the concept of auditor independence needs to be looked at from two standpoints:

- First, the relationship that the auditors have with senior management and, in particular, the finance department and whether the relationship has become compromised due to familiarity, excessive awards of non-audit work, or other factors; and
- The second issue is the processes and procedures that are in place within the audit firm to ensure that they not only provide a professional and independent service but can provide the necessary audit trail to demonstrate to the respective company's audit committee, and if ever challenged, the external world, that they provided a professional and independent service. For auditors and companies this has moved following the Enron debacle to one of reputational risk management. Neither can afford to allow a "cosy" relationship to be created or exist.

Companies may wish to consider with their auditors procedures for ensuring both audit continuity and independence. Auditors, however, are of course subject to the partner rotation requirements of the Auditing Practices Board's ethical standards.

The subject of auditor independence underlies many of the guidance questions, in all three checklists.

Company – Auditor Relationship

Equally important for the audit committee is the culture of senior management and in particular the finance department. Where the important values of transparency, honesty, accountability and integrity exist on the part of the auditor and the company, this should facilitate a good working relationship (mutual trust) which provides a value added service to the shareholders and a professional relationship between senior management, the finance department, the audit committee and the auditors.

The monitoring of the ongoing relationship between the auditors and the company is fundamentally important and one in which both the executive directors and the non-executive directors have important roles to play.

While much of this is about independence, it is also about transparency and trust. A relationship which is independent without the ingredients of transparency and trust will not necessarily provide short or long term benefits. What the audit committee requires to address is both the independence of the auditor, the culture of the management and the level of transparency and trust that exists between management and the auditors.

Management for their part should be prepared to engage, and openly discuss issues, with the auditors, and should seek to work with them in a professional manner. If the auditors are objective and are providing an independent sounding board then this provides a source of valuable assistance for management. If management cannot convince the auditors that a proposed course of action is appropriate, then they will need to consider an alternative course of action.

The acid test for management, boards and auditors should be – would they be happy to explain fully what they are doing to the shareholders? If the answer is no then they probably should not be doing it!

The importance of the company - auditor relationship and, in particular, open and honest communication between the auditors and audit committee is emphasised throughout the guidance questions.

The Tender Process

Audit tenders are costly exercises for both management and the audit firms. They tie up significant amounts of time and both parties incur significant costs. That said, the occurrence of a tender is unlikely to be required on a frequent basis and, in such cases where they are deemed appropriate, the time and cost incurred will normally be fully justified.

The audit tender process is very important and should be planned and executed by the audit committee and executive management.

Prior to entering into a tender process, careful consideration needs to be given as to what the board is seeking to achieve. Indeed, all boards should consider consultation with the major shareholders prior to commencing the process as the auditors are shareholder appointed and, as such, consultation is the appropriate way to proceed under best corporate governance practice.

Indeed, it is likely that certain major institutional shareholders will develop their own internal policies or procedures linked to their interpretation of best practice and, as such, issues such as audit tenders will be issues upon which institutions will not only have a view but will wish to have input into prior to the tender process being commenced.

Having determined the purpose of the tender process and the possible entrants, the audit committee may require to reduce this to a feasible number of audit firms. It is suggested that less than three participants, particularly if the current auditors are part of the process, would not provide a robust tender. After the initial stages of the process, the audit committee would seek to reduce the prospective firms to a shortlist, with whom more detailed discussions could be held.

These matters are reflected in the guidance questions on the selection and appointment of a new audit firm.

Practical Approach – How to use this Guide

Our model for assessing the company's auditors is set out in the flowchart on pages 13 and 14.

The checklist on ongoing auditor review sets out some trigger points which may indicate to the audit committee that it needs to consider, through a limited scope review or a full annual assessment, the position of the auditors and whether they should be replaced. It is recommended that the chairman of the audit committee uses this checklist in the context of his or her regular discussion with company executives and the finance department, and as an aide-memoire for reporting back to audit

committee meetings. The audit committee could also use this as a checklist to be reviewed at some or all of its meetings throughout the year.

The extent of any limited scope review will be dependent on the issue which has arisen and the nature of what needs to be addressed. It is suggested that this review could be undertaken using the appropriate section or sections of the full annual assessment checklist, but without using all the guidance questions contained therein.

The annual audit assessment checklist provides guidance to audit committees when performing the annual assessments as required by Sir Robert's Combined Code guidance. This checklist is framed in the context of the assessment taking place after the conclusion of the annual audit. Where this checklist is used at an earlier stage, possibly as a result of the occurrence of some trigger point during the year, a number of the guidance questions may not be directly applicable or may be applicable only in the context of the previous year's audit.

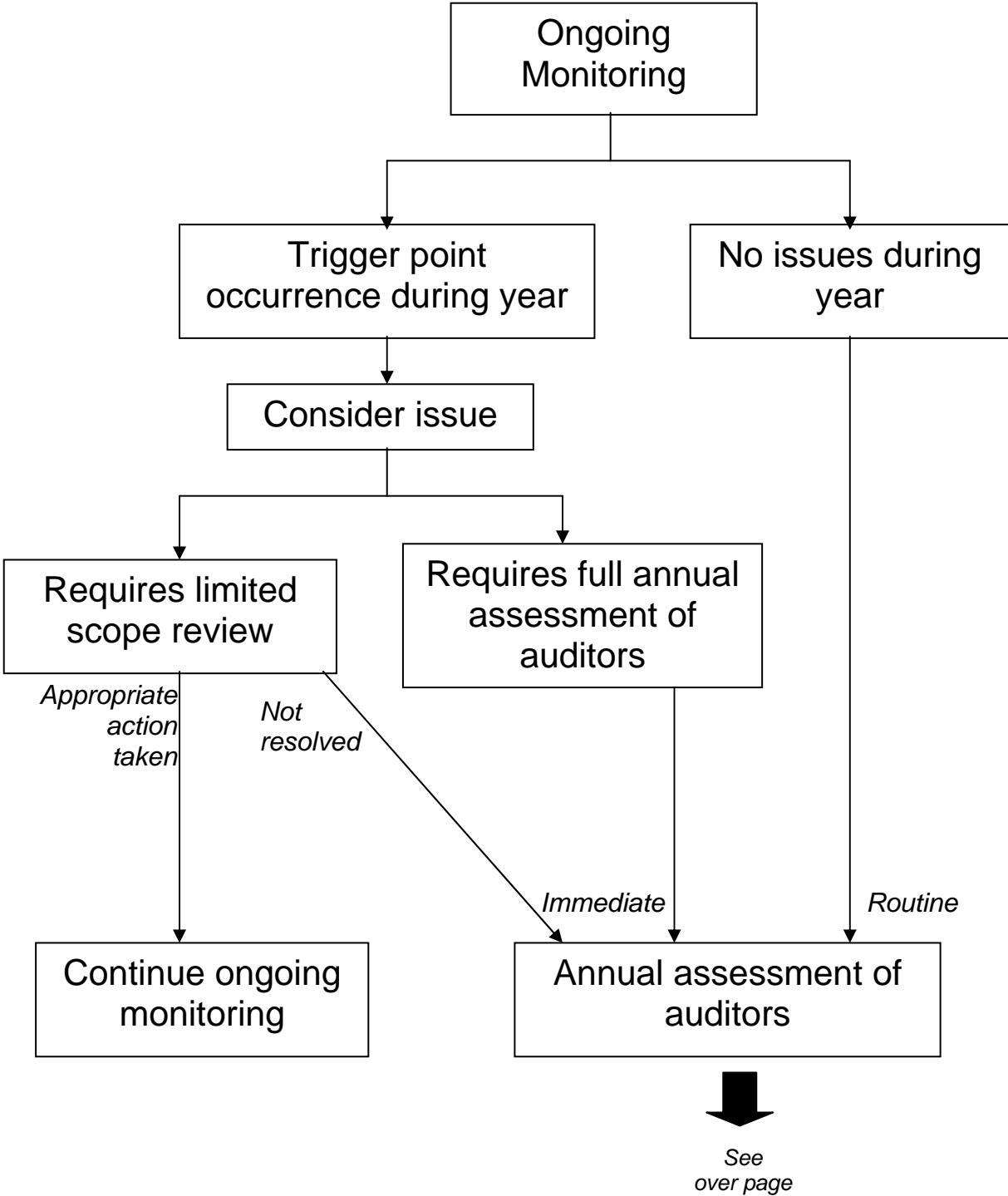
An unsatisfactory conclusion on the incumbent auditors arising from the annual audit assessment would be likely to lead to a tender process for the selection and appointment of a new audit firm. The checklist for selection and appointment of a new audit firm provides guidance to the audit committee on this process.

It should be recognised that, whilst the guidance questions in these checklists have been drawn up in the context of a company, many businesses operate through groups of companies. The application of the checklists to group situations will depend on the individual circumstances of the company and the group, the degree to which the audit of the group is undertaken by the parent company auditors, and the approach taken by the parent company audit committee in its relationship with the respective auditors of the group.

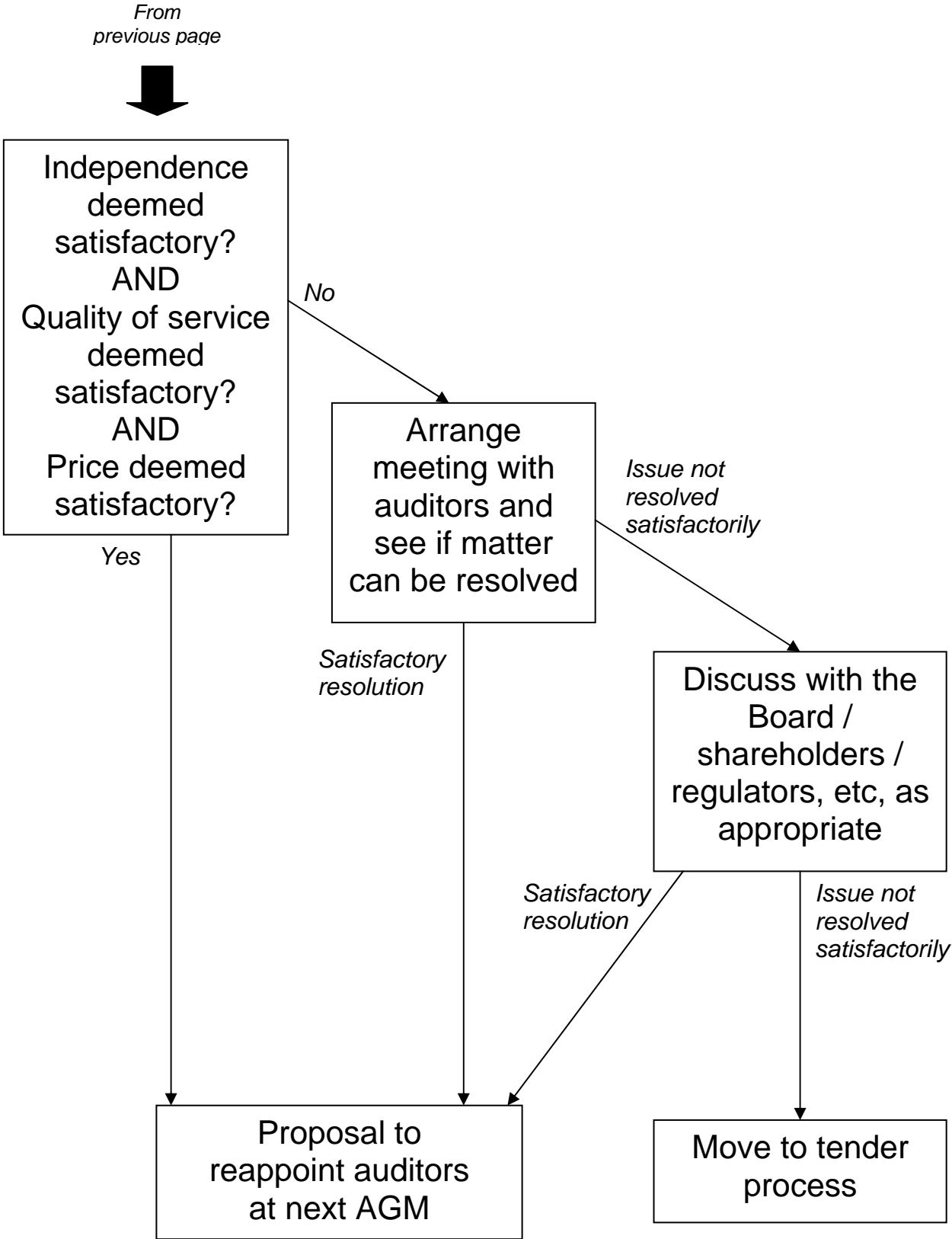
Conclusion

We hope that these guidance questions are found to be helpful for audit committees in their relationship with their company's auditors. We would be grateful for any comments, so that we can update and improve these in future.

Flowchart: Auditor Assessment (1)



Flowchart: Auditor Assessment (2)



Audit Committee Guidance Questions

Possible Trigger Points from Ongoing Auditor Review

	<u>No Issue</u>	<u>Issue to be Addressed</u>
Internal Procedural Issues (which could indicate a breakdown in independence)		
1. Company policy for award of non-audit work to auditors does not exist, is out of date or has not been reviewed within the last 15 months.	<input type="checkbox"/>	<input type="checkbox"/>
2. Award of non-audit work is made which is outwith the policy.	<input type="checkbox"/>	<input type="checkbox"/>
Change in Relationship		
3. Did the audit team comprise audit partner(s) and staff at appropriate levels of seniority, audit qualification, relevant industry experience and expertise?	<input type="checkbox"/>	<input type="checkbox"/>
4. Has the audit partner or a senior member of the audit team left the audit engagement or the audit firm, and are future audit staffing arrangements deemed satisfactory?	<input type="checkbox"/>	<input type="checkbox"/>
5. Has the firm withdrawn from an activity or location which was core to the original appointment, or changed its business arrangements such that possible conflicts of interest may arise?	<input type="checkbox"/>	<input type="checkbox"/>
6. Has the company recruited a key member of the audit engagement team to a senior position in the company's finance function and if so has action been taken in line with APB Ethical Standard 2?	<input type="checkbox"/>	<input type="checkbox"/>
7. Has there been a communication breakdown between a key member of the audit engagement team and the company, in particular, its key executives, its finance department or the chairman of its audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
8. Has there been any disagreement between management and the auditors of a material nature?	<input type="checkbox"/>	<input type="checkbox"/>
9. Has there been any unscheduled non-attendance by the auditor at an audit committee meeting?	<input type="checkbox"/>	<input type="checkbox"/>
10. Are there any other circumstances in the engagement letter, such as limitation of liability, which materially affect the relationship?	<input type="checkbox"/>	<input type="checkbox"/>
Change in Independence		
11. Does the company policy ensure that the audit firm is not engaged to provide non-audit services where this would result in:		
a. the auditors auditing their own firm's work	<input type="checkbox"/>	<input type="checkbox"/>
b. the audit firm making management decisions	<input type="checkbox"/>	<input type="checkbox"/>
c. a joint interest between the company and the auditors	<input type="checkbox"/>	<input type="checkbox"/>
d. the audit firm acting in the role of advocate for the company	<input type="checkbox"/>	<input type="checkbox"/>
e. other potential conflicts of interest have been identified, and	<input type="checkbox"/>	<input type="checkbox"/>
f. has the company complied with this policy in the awarding of all non-audit engagements to the auditors?	<input type="checkbox"/>	<input type="checkbox"/>

		<u>No Issue</u>	<u>Issue to be Addressed</u>
12.	Have there been personnel changes in the audit team or company which could create a perception that the auditors are no longer independent?	<input type="checkbox"/>	<input type="checkbox"/>
13.	Have there been changes in the nature of the audit firm's or the company's businesses which could create a perception that the auditors are no longer independent?	<input type="checkbox"/>	<input type="checkbox"/>
14.	Have any of the company's accounting policies or disclosures been brought into question or publicly challenged (eg by the Financial Reporting Review Panel or in adverse press comment) such that the auditors' independence/judgement is questioned?	<input type="checkbox"/>	<input type="checkbox"/>
15.	Have any comments or questions been raised by regulators or shareholders regarding issues of auditor independence or ability?	<input type="checkbox"/>	<input type="checkbox"/>
16.	Is the relationship between auditors and management deemed too close, eg are corporate hospitality levels such that independence must be questioned?	<input type="checkbox"/>	<input type="checkbox"/>
17.	Have any other matters arisen or been notified to the audit committee which cast doubt on the independence of the auditors or individual members of the audit team?	<input type="checkbox"/>	<input type="checkbox"/>
Change in Competence			
18.	Have any key staff members departed from the audit firm such that this calls into question the ongoing competence of the auditors?	<input type="checkbox"/>	<input type="checkbox"/>
19.	Have there been any changes in the nature or size of the audit firm's or the company's business which indicate that the auditors may no longer have the necessary competence or specialist expertise to perform the audit?	<input type="checkbox"/>	<input type="checkbox"/>
20.	Has any material error, sequence of errors, or omissions been discovered which should have been identified previously as part of the audit process?	<input type="checkbox"/>	<input type="checkbox"/>
21.	Has any control breakdown been discovered which could have resulted in a material error, and which should have been identified previously as part of the audit process?	<input type="checkbox"/>	<input type="checkbox"/>
Communication			
22.	Have the auditors communicated with the audit committee according to their timetable and on a timely basis, or have the communications been late or the information incomplete?	<input type="checkbox"/>	<input type="checkbox"/>
23.	Were issues arising from the audit raised with management or the appropriate person within the finance team in an appropriate and timely manner?	<input type="checkbox"/>	<input type="checkbox"/>
24.	Have the auditors reported all significant issues, or adverse or unexpected findings, to the audit committee on a timely basis?	<input type="checkbox"/>	<input type="checkbox"/>
25.	Have there been any material fee overruns in any area of work being conducted by the auditors which have not been communicated or explained to the audit committee in advance of the work being concluded?	<input type="checkbox"/>	<input type="checkbox"/>
Other Matters			
26.	Has the audit firm been involved in an issue which causes it reputational damage and which could bring into question the auditors' professionalism and independence, or the firm's financial stability?	<input type="checkbox"/>	<input type="checkbox"/>
27.	Have any incidences of whistleblowing occurred which may call into question the independence, professionalism and objectivity of the auditors or the effectiveness of the audit process?	<input type="checkbox"/>	<input type="checkbox"/>
28.	Have any issues been referred from divisional controllers or subsidiaries which may call into question the appropriateness of the company or group auditors?	<input type="checkbox"/>	<input type="checkbox"/>

	<u>No Issue</u>	<u>Issue to be Addressed</u>
29. Has there been any other issue, the outcome of which causes the audit committee concern?	<input type="checkbox"/>	<input type="checkbox"/>
30. Has the audit committee properly documented its conclusions?	<input type="checkbox"/>	<input type="checkbox"/>

Points to note

There is no prescribed list of other issues which the chairman of the audit committee or the audit committee itself should monitor on an ongoing basis. However, they should be ever vigilant to any factor which could bring into question the independence, objectivity and effectiveness of the auditors.

In considering the possible trigger points from the ongoing auditor review the audit committee will require to engage support from various internal control functions as well as seeking input from the chief executive, the finance director and the company secretary. They will also need to discuss matters with the external auditors. In conducting this review wisdom, objectivity, and judgement will be required by the audit committee in formulating their assessment and conclusions.

Audit Committee Guidance Questions

Annual Audit Assessment

	<u>No Issue</u>	<u>Issue to be Addressed</u>
Independence and Objectivity		
1. Has the audit committee received documented reassurance that the auditors and their staff have no family, financial, employment, investment or business relationship with the company?	<input type="checkbox"/>	<input type="checkbox"/>
2. Has the audit committee received from the audit firm on an annual basis, in writing where appropriate, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, to enable it to monitor the group's auditors' compliance with professional ethical guidance and in particular has this covered the following:		
a) the rotation of audit partners and staff?	<input type="checkbox"/>	<input type="checkbox"/>
b) the level of fees that the company pays in proportion to the overall fee income of the firm, office and partner?	<input type="checkbox"/>	<input type="checkbox"/>
c) the nature of other services provided to the company?	<input type="checkbox"/>	<input type="checkbox"/>
d) any relationships between the audit firm and its staff and the company?	<input type="checkbox"/>	<input type="checkbox"/>
e) office and business procedures including partner and senior manager incentive arrangements?	<input type="checkbox"/>	<input type="checkbox"/>
f) overall confirmation of the auditors' independence and objectivity?	<input type="checkbox"/>	<input type="checkbox"/>
3. Have the auditors met with the audit committee and discussed their objectivity and independence in an appropriately open and straightforward manner?	<input type="checkbox"/>	<input type="checkbox"/>
4. Have the auditors provided information, including the number of former employees currently employed in senior positions in the company, to enable the audit committee:		
a) to monitor application of the company policy on employment of former employees of the audit firm?	<input type="checkbox"/>	<input type="checkbox"/>
b) to consider whether there has been any impairment, or appearance of impairment, of the auditors' judgement or independence in respect of the audit?	<input type="checkbox"/>	<input type="checkbox"/>
c) to ensure compliance with the board approved company policy for the employment of former employees of the audit firm, who were part of the audit team and moved directly to the company?	<input type="checkbox"/>	<input type="checkbox"/>
5. Has the audit committee taken into account best practice regarding the provision of non-audit services by the auditors and satisfied itself that:		
a) the auditor does not audit its own firm's work?	<input type="checkbox"/>	<input type="checkbox"/>
b) the auditor does not make management decisions for the company?	<input type="checkbox"/>	<input type="checkbox"/>
c) no joint interest between the company and the auditors is created?	<input type="checkbox"/>	<input type="checkbox"/>
d) the auditor is not put in the role of advocate for the company?	<input type="checkbox"/>	<input type="checkbox"/>
6. Notwithstanding the above, does the audit committee regard the relationship between auditors and management as too close, such that the auditors may lack, or appear to lack, the required degree of objectivity?	<input type="checkbox"/>	<input type="checkbox"/>
7. Have any other matters arisen or been notified to the audit committee which cast doubt on the independence of the auditors or individual members of the audit team?	<input type="checkbox"/>	<input type="checkbox"/>

	<u>No Issue</u>	<u>Issue to be Addressed</u>
Financial Stability and Risk Profile of the Firm		
8. By reference to the auditor's litigation record, financial assets, the structure of the firm and its professional indemnity insurance cover, has the audit committee considered the firm's financial stability and whether it has the ability to meet any claims which might arise from the audit engagement?	<input type="checkbox"/>	<input type="checkbox"/>
Audit Strategy		
9. Did the auditors communicate their strategy for the audit to the audit committee, and did that communication include the undernoted, where relevant:		
a) terms of reference including an engagement letter or letters covering the statutory audit and corporate governance, and an independence letter?	<input type="checkbox"/>	<input type="checkbox"/>
b) a relationship chart summarising the key auditor -company/group relationships by division and function?	<input type="checkbox"/>	<input type="checkbox"/>
c) relationship to any other auditor in the UK or overseas?	<input type="checkbox"/>	<input type="checkbox"/>
d) the appointment of an independent review partner who has not had any prior involvement with the company or group?	<input type="checkbox"/>	<input type="checkbox"/>
e) the audit approach and scope?	<input type="checkbox"/>	<input type="checkbox"/>
f) audit arrangements for other group companies and divisions?	<input type="checkbox"/>	<input type="checkbox"/>
g) audit arrangements in relation to service organisations supplying outsourced functions?	<input type="checkbox"/>	<input type="checkbox"/>
h) the auditors' assessment of company or group treasury operations and the proposed audit arrangements?	<input type="checkbox"/>	<input type="checkbox"/>
i) the level of audit materiality adopted for the audit, and justification for this amount?	<input type="checkbox"/>	<input type="checkbox"/>
j) the timetable for the audit and for verbal and written communication to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
k) the role and scope of internal audit and the extent of any reliance to be placed by the auditors on the internal audit function?	<input type="checkbox"/>	<input type="checkbox"/>
l) the auditors' understanding of the company's IT strategy and their approach to the audit of IT systems?	<input type="checkbox"/>	<input type="checkbox"/>
m) accounting developments and financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>
n) an assessment of group accounting and business risks, both qualitative and quantitative, and how they will be addressed as part of the audit approach, including use of experts in specialist or complex areas?	<input type="checkbox"/>	<input type="checkbox"/>
o) additional assurance services and the nature of any reports required in addition to the statutory audit report, eg on corporate governance matters, the business review or on environmental or ethical policies and procedures?	<input type="checkbox"/>	<input type="checkbox"/>
p) outline of fee proposal including reasons for major changes from prior year and fee analysis by scope and hours?	<input type="checkbox"/>	<input type="checkbox"/>
q) key aspects of the auditors approach to ensuring continuous audit quality?	<input type="checkbox"/>	<input type="checkbox"/>

	<u>No Issue</u>	<u>Issue to be Addressed</u>
10. In determining their audit strategy, did the auditors state that they would ensure that:		
a) they would evaluate the key risks of misstatement in the financial statements and allocate resources and focus their work accordingly?	<input type="checkbox"/>	<input type="checkbox"/>
b) they would maintain an open and regular dialogue with management so that issues are identified and dealt with early?	<input type="checkbox"/>	<input type="checkbox"/>
c) where the company's own internal controls are considered effective, they would test and place reliance on them where appropriate to maximise the cost/benefit of the audit?	<input type="checkbox"/>	<input type="checkbox"/>
d) there is a good working relationship with the company's internal audit function and, where relevant, other assurance functions?	<input type="checkbox"/>	<input type="checkbox"/>
e) they would maintain an appropriate level of continuity of all key personnel worldwide and would manage the audit on a basis that mirrors the company's or group's own structure?	<input type="checkbox"/>	<input type="checkbox"/>
f) they remain independent and objective in their assessment of the company or group financial statements and the issues which arise?	<input type="checkbox"/>	<input type="checkbox"/>
g) previously identified issues were followed through to a satisfactory conclusion?	<input type="checkbox"/>	<input type="checkbox"/>
11. Was the audit approach at each group company or division agreed in advance with the divisional controllers and determined by materiality of the company or division to the group, local legislative requirements or an assessment of the audit risks inherent in and specific to that company or division?	<input type="checkbox"/>	<input type="checkbox"/>
12. Where a significant part of the group's operations is audited by a firm other than the parent company auditors, has the audit committee satisfied itself that:		
a) The parent company auditors are satisfied with the existing audit arrangements as a basis for their audit opinion on the consolidated group accounts?	<input type="checkbox"/>	<input type="checkbox"/>
b) The audit arrangements do not contravene the rules of any relevant regulatory body (such as the US Securities and Exchange Commission, in relation to US listings)?	<input type="checkbox"/>	<input type="checkbox"/>
13. Was the scope of the audit work at each entity categorised under broad headings such as full scope, limited scope and high level visit, with appropriate category description?	<input type="checkbox"/>	<input type="checkbox"/>
14. Was the timing of the auditors' procedures and their communication with the audit committee tailored to the annual reporting cycle?	<input type="checkbox"/>	<input type="checkbox"/>
15. Did the auditors explain what would be communicated to the audit committee and when, eg the audit strategy, any half year review report, adverse and unexpected findings, and the final report to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
Communication of Adverse or Unexpected Findings		
16. Were issues, including adverse or unexpected findings, communicated on a timely basis?	<input type="checkbox"/>	<input type="checkbox"/>
17. Did the auditors identify the extent to which anticipated audit and accounting issues might have an impact on the year-end process?	<input type="checkbox"/>	<input type="checkbox"/>
18. Was the actual or potential resolution of significant audit and accounting issues discussed and agreed with division, company and group management and documented for audit committee consideration and, if necessary, what follow up has there been?	<input type="checkbox"/>	<input type="checkbox"/>
19. Did the auditors report on the companies or divisions where there were either new concerns regarding the control environment or update the position where there had been historic concerns?	<input type="checkbox"/>	<input type="checkbox"/>
20. Did the auditors provide an update on new exposure drafts and financial reporting developments and identify those which were applicable to the company?	<input type="checkbox"/>	<input type="checkbox"/>

		<u>No Issue</u>	<u>Issue to be Addressed</u>
Finalisation of the Audit			
21.	Did the auditors provide the audit committee with a final report on the full year audit in advance of the board meeting to approve the annual accounts?	<input type="checkbox"/>	<input type="checkbox"/>
22.	Did the audit scope and fees change from that reported at the previous audit committee meetings and have such changes been satisfactorily explained in the report?	<input type="checkbox"/>	<input type="checkbox"/>
23.	Has a schedule of fees for non-audit services been provided in the report, and has this been approved by the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
24.	Did the report summarise the key features of the final phase of the audit cycle?	<input type="checkbox"/>	<input type="checkbox"/>
25.	Did the report provide an overview of results and report upon significant audit and accounting issues; particularly those of a subjective or judgemental nature?	<input type="checkbox"/>	<input type="checkbox"/>
26.	Did the auditors provide details of adjustments, misstatements or errors?	<input type="checkbox"/>	<input type="checkbox"/>
27.	Did the auditors ask for written representations as to the reasons why these errors were not adjusted?	<input type="checkbox"/>	<input type="checkbox"/>
28.	Did the auditors provide details of any occurrences of material fraud or errors and discuss these with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
29.	Did the auditors request from the management, board of directors or audit committee details of any suspected or actual non-compliance with laws and regulations, and were any material matters discussed with the audit committee and appropriately taken forward?	<input type="checkbox"/>	<input type="checkbox"/>
30.	Did the auditors properly address the issue of going concern with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
31.	Did the auditors provide their views on the qualitative aspects of the company's accounting practices and financial reporting?	<input type="checkbox"/>	<input type="checkbox"/>
32.	Did the auditors identify significant issues relating to accounting treatments where management's view of the preferred treatment differed from their own?	<input type="checkbox"/>	<input type="checkbox"/>
33.	Did the auditors confirm to the audit committee that they were satisfied that the procedures adopted by the company were sufficient to meet the relevant corporate governance requirements, including the provisions of the latest applicable code(s) and guidance, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
34.	Did the final phase of the audit reveal any significant audit and accounting issues which had not been identified in earlier communications to the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
35.	Did the auditors carry out a thorough and robust subsequent events review, including enquiry of, and discussion as appropriate with, management or the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
36.	Did the auditors request details of related parties and controlling parties, including enquiry of, and discussion as appropriate with, management or the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
37.	Did the auditors identify any areas for improvement in their audit approach and discuss these with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
38.	Did the auditors make constructive recommendations on improving the company's control environment?	<input type="checkbox"/>	<input type="checkbox"/>

	<u>No Issue</u>	<u>Issue to be Addressed</u>
39. Did the auditors provide details of significant weaknesses in the accounting and internal control systems found during the audit, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
40. Did the auditors consider the appropriateness and effectiveness of the company's broader risk management processes, and were any recommendations for improvement considered to be practical and effective?	<input type="checkbox"/>	<input type="checkbox"/>
41. Did the letter of representation address appropriate issues, and had due consideration been given by the auditors to the appropriateness of their reliance on management representations?	<input type="checkbox"/>	<input type="checkbox"/>
42. Did the auditors confirm that their independence had continued throughout the audit?	<input type="checkbox"/>	<input type="checkbox"/>
43. Did the auditors issue a standard unqualified audit opinion on the financial statements or, if the opinion was non-standard (qualified or subject to a significant/material uncertainty), was the issue of concern and the impact on the audit report identified at a sufficiently early stage in the audit and discussed with the audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
Concluding Matters		
44. Did the audit team comprise audit partner(s) and staff at appropriate levels of seniority, experience and expertise?	<input type="checkbox"/>	<input type="checkbox"/>
45. Has there been a good working relationship between the members of the audit engagement team and the company, in particular, its key executives, its finance department and the chairman of its audit committee?	<input type="checkbox"/>	<input type="checkbox"/>
46. Has the finance director, head of internal audit and other members of senior management provided positive feedback on the quality of the audit work?	<input type="checkbox"/>	<input type="checkbox"/>
47. Has the auditor been sufficiently robust in dealings with the finance director and other company management?	<input type="checkbox"/>	<input type="checkbox"/>
48. Has the auditor attended meetings with the audit committee without management present, and been sufficiently transparent and incisive?	<input type="checkbox"/>	<input type="checkbox"/>
49. Has the auditor notified and discussed with the audit committee any problems arising in dealings with the finance and other directors and other company or group management, including concerns as to the competence and integrity of these individuals?	<input type="checkbox"/>	<input type="checkbox"/>
50. Does the audit committee consider that the audit was effective?	<input type="checkbox"/>	<input type="checkbox"/>
51. Does the audit committee recommend to the board the reappointment of the incumbent auditors?	<input type="checkbox"/>	<input type="checkbox"/>
52. Has the audit committee properly documented its conclusions?	<input type="checkbox"/>	<input type="checkbox"/>
53. Has the audit firm requested a liability limitation agreement be put in place, and are the proposed terms reasonable and likely to be accepted by the shareholders?	<input type="checkbox"/>	<input type="checkbox"/>

Point to note

In undertaking the annual audit assessment the audit committee will require to engage support from various internal control functions as well as seeking input from the chief executive, the finance director and the company secretary. They will also need to discuss matters with the external auditors. In conducting this review wisdom, objectivity, and judgement will be required by the audit committee in formulating their assessment and conclusions.

Audit Committee Guidance Questions

Selection and Appointment of New Audit Firm

Actioned?

Audit Tender Consideration Process

1. Have the reasons for putting the audit out to tender been clearly debated so the committee can discuss why it intends to do so with the board, major shareholders and other appropriate parties, such as regulators in regulated industries, prior to starting the process?
2. Have views been sought from major shareholders, regulators, and other appropriate parties independent of the board?

Background Information

3. Has an industry analysis been performed to ascertain who it would be appropriate to invite to participate in the tender process?
4. Does this include:
 - a) Reputations of firms?
 - b) Industry knowledge?
 - c) Any past experience of firms?
 - d) Financial stability, risk profile and litigation record?
 - e) Any personal references?
5. Has a list of necessary skills and services been prepared?

Current Capabilities

6. Do any potential conflicts exist, such as existing relationships or engagements with the company, which could exclude a particular firm from the tender process?
7. Does the firm have the size, resources and coverage required to audit the company or group?
8. Does the company's audit or other assurance requirement necessitate specialist skills – e.g. actuarial skills, and does the audit firm possess these skills?

The Initial Tender Process – Phase 1

9. Have management prepared and the audit committee reviewed an invitation to tender which will allow all parties to tender on an equal footing? Have detailed specifications been prepared as to the desired content of the written proposals to be received by the audit committee?
10. Does the invitation to tender provide the following information to the prospective audit firms:
 - a) Financial performance?
 - b) Control framework?
 - c) Previous audit committee minutes?

- d) Previous audit committee papers?
- e) Organisation structure charts?
- f) Prior year accounts?
- g) Accounting procedures manuals?
- h) Reporting procedures manuals?
- i) Other relevant information?
- 11. Have the relevant parties signed a confidentiality letter prior to receiving information?
- 12. Have the relevant parties provided a draft statement of independence which will require to be signed if they are successful?
- 13. Has a timetable been prepared for the process, including adequate access to senior management, finance personnel and the audit committee? Is the timetable feasible?
- 14. Has it been agreed that a member of the audit committee should attend some of the meetings with senior management?
- 15. Has a checklist for scoring each firm's written submission been prepared?
- 16. Have plans been made for determining the shortlist, the likely number of firms involved, and what format phase 2 of the tender process will take?

The Due Diligence Tender Process – Phase 2

- 17. Have plans been made for the shortlisted firms to visit selected typical company or group operations?
- 18. Has it been agreed whether these visits will result in expanded written submissions or only a final presentation?
- 19. Has a process been established for the management of the visited operations to score the shortlisted firms?
- 20. Has a list of questions been prepared to be addressed in the final presentations? Has a list of subjects been prepared for the prospective audit firms to address in their final written submissions?
- 21. Will the shortlisted auditors be asked to comment on the group's accounting and financial reporting manuals, consolidation pack, and other relevant documentation used by all company or group operations?
- 22. Has it been decided who from the company should attend the face to face presentations – audit committee, management, others - and have dates been reserved for these? Has it been decided who will consider the prospective audit firms' final written submissions?
- 23. Has a checklist for scoring each firms' submission or presentation been prepared?
- 24. Are the people presenting to the audit committee those that will conduct the audit?

25. Are expected audit hours and scale rates comparable with other firms?
26. Is the audit firm willing to disclose its percentage recovery on chargeable time, and if so, what does this indicate?
27. Has a draft joint press communication been prepared and agreed in advance with the shortlisted parties on a confidential basis, together with the intended timing of its release after the final selection process has been completed?
28. Have the following factors been considered in making the final decision on the appointment of the auditors:
- a) Reputation and financial stability of the firms?
 - b) Views of shareholders, regulators and financiers?
 - c) Previous experience and recommendations from others?
 - d) Value for money?
 - e) Personality and experience of the key audit staff?
 - f) Depth of audit team expertise and technical back-up?
 - g) Industry expertise?
 - h) Geographic service capability?
 - i) Independence and objectivity?
 - j) Procedure for ensuring continuing independence and objectivity?
 - k) Any proposed liability limitation agreement?
29. Has the audit committee properly documented its conclusions?

Points to note

If the decision is made following a tender process to change the current auditor and appoint new auditors, then there will be various legal and procedural matters which will need to be addressed. For companies which do not have in-house legal departments, this may involve seeking external advice. This should be undertaken once a decision has been made but prior to any public announcement.

In considering the selection and appointment of a new audit firm the audit committee will require to engage support from various internal control functions as well as seeking input from the chief executive, the finance director and the company secretary. They will also need to discuss matters with the external auditors. In conducting this selection wisdom, objectivity, and judgement will be required by the audit committee in formulating their assessment and conclusions.



CA HOUSE • 21 HAYMARKET YARDS • EDINBURGH • EH12 5BH
TEL: 0131 347 0240 • FAX: 0131 347 0110
E-MAIL: accountingandauditing@icas.org.uk • WEB: www.icas.org.uk