



## Best Practice for Audit Committees: Monitoring the Independent Auditor

*Frank Scheuerell, a managing director with Navigant, and Paul Breene, a partner with Reed Smith LLP, explore key issues of auditor independence and the impact of the Sarbanes-Oxley Act on audit committee roles and responsibilities.*

With the passage of the Sarbanes-Oxley Act of 2002 (the Act) nearly 10 years ago the responsibilities and roles of the audit committee and independent auditors dramatically changed. Under the Act, it is the audit committee's responsibility to oversee the independent auditor. The Act essentially expanded the role of the audit committee to include, among other items, to hire, retain, dismiss, evaluate and compensate the independent auditor. It also prescribed the audit committee to approve non-audit services and monitor auditor independence issues.

Fast forward to today and both the public and regulators are still questioning whether auditors are truly independent. Both the Public Company Accounting Oversight Board (PCAOB) and the European Commission (EC) are considering mandatory audit firm rotation. The EC is also considering prohibiting audit firms from performing non-audit services for their clients. While many organizations are against mandatory firm rotation, auditor independence is a problem that rests squarely with the audit committee. Now it is more critical than ever for the audit committee to ensure the auditor remains independent in fact and appearance.

We have listed below some best practices for audit committees to keep in mind when selecting independent auditors and monitoring non-audit services and auditor independence issues.

### Monitoring an existing auditor relationship:

- New PCAOB rules require that a potential or existing auditor disclose in writing any independence issues and confirm its independence. The auditor is also required to discuss with the audit committee its independence and document the substance of the discussion. Be aware of any existing personal or financial relationships between the auditor and the company, or its directors and officers, that might affect independence of the auditor.

- Evaluate non-audit services that are proposed by the auditor. The audit committee should ensure that non-audit services will not place the auditor in a position of auditing their own work

at a later point in time. The auditor should not function as a part of management or act as an advocate for the company. For example, the auditors should not be involved with the initial research and development of accounting policies for new transactions or with the implementation of a new accounting pronouncement.

### Changing auditors:

- Has the proposed independent auditor been engaged by the company within the past few years regarding the application of accounting principles to a specific transaction (either completed or proposed); the type of audit opinion that might have been rendered; or any matter upon which there was disagreement with respect to these issues?

- Has the proposed independent auditor made proposals regarding changes to current accounting principles, or the manner in which the company has been reporting on its business which could significantly increase reported revenues or earnings or materially increase reported assets of the company?

### Selecting an independent auditor:

- Does the auditor have experience working in the industry of which the company is a part—and in any countries beyond the U.S. where the company has operations?

- Require a detailed outline of the audit plan proposed, staffing and procedures.

- Require the prospective auditor's internal control procedures to guarantee the uniform quality of the audit and compliance with auditor independence requirements.

- Understand the financial impact of the audit fee to the auditing firm.

- Require the auditor's recent record with respect to work done for clients and whether any of its audits required either restatements, changes in previously issued audit reports, legal settlements or disciplinary or enforcement proceedings before the SEC or PCAOB.

- Consider the likelihood that the auditor's team will work effectively with, and challenge, management while remaining independent.

Contact Frank Scheuerell at [frank.scheuerell@navigant.com](mailto:frank.scheuerell@navigant.com) and Paul E. Breene, Esq. at [pbreene@reedsmith.com](mailto:pbreene@reedsmith.com). Access other GC Corner articles by visiting [www.navigant.com/gccorner](http://www.navigant.com/gccorner).