Twelve important guidelines for audit committees

KPMG Board Leadership Centre

In the wake of the US Public Company Accounting Oversight Board ("PCAOB") reporting a troubling increase in deficiency rates found in its recent inspections, the SEC's Chief Accountant, Paul Munter, recently made a call for a commitment to professional scepticism and audit quality.

In a statement made on 5 February, Paul Munter reaffirmed that audit committees have a crucial role in promoting audit quality and protecting investors. While reiterating that audit quality is necessary for making financial reporting reliable and useful, which in turn affects investor trust and market efficiency, he went on to note to assert that audit quality can be impaired by various factors, such as management preferences, auditor optimism, or audit committee supineness.

To exercise their duty to protect investors, Chief Accountant Munter went on to outline a twelve basic principles or guidelines to which audit committees should adhere.

1. Select an auditor based on their ability to perform a high-quality audit, with the requisite degree of professional scepticism.
2. Compensate and oversee the auditor to with a view to promoting audit quality and protecting investors.
3. Avoid any association or 'coziness' with the company or its management, or management influence, that might impair audit quality or the interests of investors.
4. Regularly review the auditor's performance using relevant measures and feedback, including the results of public inspection reports; whether the audit team has appropriate industry expertise, engagement, and leadership; and the audit team's total hours and staffing.
5. Support the auditor's independence and facilitate the auditor's exercise of professional scepticism.
6. Help reduce any barriers to the auditor exercising professional scepticism by forming a strong professional relationship with the auditor, independent of management.
7. Have an open dialogue with the auditor that provides adequate time for in-depth discussions of financial reporting and internal control matters.
8. Dedicate time to asking the auditor probing questions to assess audit quality.
9. Speak directly with the audit team about the importance of professional scepticism and show the audit committee's support.
10. Observe and assess the tone and quality of the auditor's interactions with management.
11. Meet with the auditor, independent of management, through both formal and informal meetings.
12. Avoid substituting management's judgments or interactions with the independent auditor for the audit committee's own judgments and engagement with the independent auditor.

These guidelines are not new, but they are worth repeating, remembering, and upholding, especially when uncertain times create significant challenges for financial reporting and auditing.

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