



The audit tender process

The frequency of audit tenders has increased in recent years, primarily in response to the European Union's (EU) Audit Regulation and Directive (ARD), which requires many companies to put audits out for tender once the incumbent auditor has served for 10 years. While the ARD allows a company to extend the incumbent auditor's engagement in certain circumstances, a substantial number of companies have rotated auditors in the brief period since the ARD became effective.¹

When audit committees conduct tenders, they evaluate the quality of the audit firm and the individuals who will conduct the audit, as they do when they evaluate an incumbent external auditor. Yet tenders are more complex and time consuming for the audit committee, demand more engagement from management, and involve additional evaluation criteria.

Executive summary

On 13 September 2019, members of the European Audit Committee Leadership Network (EACLN) met in Munich to discuss their experiences with the tender process.² This *ViewPoints* shares background information and member perspectives on the following issues:

- **Selection criteria** (page 1)

Audit committees differentiate between audit firms by evaluating a range of criteria. In some cases, technology is a key differentiator. Audit committees also assign considerable weight to the qualifications and capabilities of the proposed audit team; not just the lead partner but also those who will serve as additional points of contact for the audit committee and management. Audit committees look for fees that accurately reflect the likely scope of the audit and the cost of the engagement.

- **The tender process and the roles of the audit committee and management** (page 5)

The tender process begins for the audit committee when it recommends to the full board that the company initiate a tender. The audit committee has authority over the process, utilizing management to craft the request for proposal (RFP) and the evaluation criteria. Management supplies the firms with data they can use to draft their bids. The audit committee and key members of management meet with auditor partners and their teams. The audit committee then recommends two top choices to the full board.

For a list of attending members, see Appendix 1 on page 8. For a list of discussion questions for audit committees, see Appendix 2 on page 9.

Selection criteria

While all Big Four firms are qualified to perform most large company audits, members noted that not all bids are alike. Firms distinguish themselves with the technology and human capital.

Fees are also a consideration, though audit chairs said proposed fees are not generally a determining factor in their decisions.

Technology

The technology that audit firms use to define, plan, and execute an audit has steadily improved in recent years. Although some members did not feel they had a clear understanding of how one firm's technology surpasses another's, other members asserted that technology can be one of the most important differentiators. One said, *"This is the biggest question in the assessment. There are differences between firms. All of the Big Four are pushing technology. I really try to understand what they have and how is it employed through demonstrations."* Another member agreed: *"I recently completed two tenders and I can tell you that technology is a huge differentiator among audit firms. In one company it was completely different from another one."* Members were eager to discuss how a firm's technological advantages can emerge during the tender process.

Technology and data analytics inform the audit plan

Audit firms use technology to develop the audit scope and strategy for each company. It is therefore critical that, during the tender process, firms demonstrate their technology and that audit committees understand how it would contribute to a quality audit. Firms use data analytics to identify potential risks they would target in an audit. *"Technology must help identify risk areas. Technology is used to assess control systems, like IT controls. It provides an overall IT perspective,"* a member said. Another member agreed: *"Ultimately, when we talk technology, it's foresight and protection."*

Members said they understand audit firms' technologies by engaging with the technology experts at the firms and at their own companies. *"The technology presentation is important. Get it from the horse's mouth,"* one member said. Another recommended, *"Bring the firms' tech people together with yours and see what those tech people say."* Another member pointed out that *"one interesting thing is to visit their lab and have finance people and tech people extract value. That helps you think about the longer-term perspective."*

One of the most effective ways for audit committees to assess a firm's technological strength is to provide firms with real data. One member recommended, *"Really try to understand what they have and how is it employed. Try to understand through reference demonstrations."* Another member shared an example: *"We gave the firms access to the data from financial account[s] and asked them to show us what to do with it. They all want to analyze data; it's a question of how they match. It's not just numbers; it's about conclusions they'd draw. We really found out quickly how they do it differently. Fundamentally there are differences to their approaches."*

Technology to perform the audit

Members said they also want confidence that the auditor's technology can help improve audit quality. Members who had been through tenders were less focused on the technical aspects of new features than on how they improve the audit. *"Working papers don't interest us,"* a member explained, *"but entire database deep diving, that's another story. If the external audit*

can get into the database, then it makes a difference.” Members also want confidence that a firm’s audit technology will evolve as a company’s business and its own technology evolves. A member explained, *“The audit firm not only must have good technology. It must invest to keep pace with the company.”*

The lead partner and audit team

Members said they evaluate the proposed audit team on a combination of experience, judgment, and other qualitative bases. *“Trust must be the overarching thing,”* a member insisted. Another member elaborated: *“The human factor is important. You need confidence in the partners, good knowledge of them, and good relationships and understanding with them.”*

Members develop the level of trust and confidence they need by examining past performance. A partner’s past work might not always be the most important selection factor, however. A member observed, *“There is an emphasis on sector experience. Partners with sector experience are important but they’re not always 100% available.”*

Members said they carefully evaluate both the lead partner and the supporting team in the tender process. Although the lead partner is a prominent figure in any bid, members tended to agree, as one member put it, that *“a really important question is who is Number 2 on the account.”* Members said it is important to ensure that all important internal stakeholders are comfortable with their counterparts on the proposed audit team. Moreover, understanding a firm’s bench strength is helpful because eventually the lead partner will have to rotate off the account.

Audit chairs also look for indications that the proposed audit team can take advantage of its own resources. As one member put it: *“Can they bring the firm with them? Can they talk to their partnership and bring the group to bear on the challenges?”* Others noted the importance of a team that has clout within its own firm, especially with the professional practice office.

Engaging with partners and the staff early in the tender process, and regularly as it unfolds, helps audit committees develop a feel for the personnel. A member reported, *“In one tender, we became familiar with the partners two years before the final presentations. In another it was two-and-a-half years.”* Another member said that time spent with the partners over many months and stages of the process was paramount: *“Nothing goes above time spent with the lead partner and team. We met not only the lead partner but also the team well ahead so they can respond if required. We then went through a stringent process involving the team within the company and had expert rounds which led to the evaluation. That was after written interviews of the companies.”*

Some members reported that the firms’ final presentations to the audit committee, or the “beauty contest,” can be the most influential part of the partner evaluation. *“I think you get a very good impression of the lead partner and the team,”* a member said at the meeting. Another member explained that even if a presentation is effective, there must be quality staff to back it up: *“We don’t benefit from an excellent presenter without a responsible team.”*

Some factors may limit whether otherwise qualified partners merit consideration—or are available at all. If a partner appears to be unable to perform the audit with full independence,

that can be a disqualifier. One member recalled a case in which *“management’s chief accountant and the bidding firm’s lead partner had been working together for many years. They were too close, so we didn’t choose that bidder. We need somebody who’s very independent.”* Another member had a similar experience and *“completely disregarded a firm for these reasons.”*

The role of fees and fee predictability

Members agree that downplaying fees during the bid evaluation process helps them focus on criteria that most affect audit quality. One member said that fees are an important but minor part of the audit committee’s overall evaluation, *“It’s very helpful and good for all parties involved if the importance of audit fees is reduced in the process.”* Members confirmed that total cost generally is a consideration, but that they are more focused on other criteria.

Practical realities, like management’s need to set a budget, mean that cost predictability and stability matter as much as the absolute cost. Audit chairs are skeptical of low-fee bids because they may indicate that the firm does not understand, or is not attending to, the likely scope and eventual cost of the audit. *“There’s a concern fees are bidding low and are looking to make it up,”* one member said. Another member agreed that *“in the beginning it’s not hard to have transparency. Then it becomes difficult to negotiate scope once you have them on board. That’s the biggest challenge: keeping the extra scope down later.”*

Asking for detailed fee proposals that correspond to the scope of the proposed audit helps audit committees and auditors develop shared expectations. *“The important thing is to have the granularity in the fee proposals. You need an understanding on how the auditors would react. Complexity can also be reduced,”* one member said. Another agreed, *“You have to force them to make the scope transparent, so you get transparency on the quality of the fee proposal. Then, you can make your own judgment.”* Negotiation can also create fee predictability, if not always stability. One member shared an approach a company took to ensure that fees remained stable: *“We got a clause in the agreement that said as long as we stay within 10% of revenues from the previous year, then the fee doesn’t change.”*

Systematically underweighting fees during the evaluation process is another way to prevent cost from interfering with quality. One member shared an experience with an *“anti-dumping”* mechanism that management had proposed to prevent low fees from being a disproportionate factor in the evaluation process. It was moderately effective: the mechanism did not end up eliminating the bid from consideration, but it did place a cap on how much benefit a firm received for placing a bid that was well below other bids.

The limited choice of audit firms and partners

Audit chairs shared mixed views about whether there are enough audit firms for large companies to choose from. Almost all members acknowledged that their choices are limited to the Big Four firms. In cases where rotation is mandatory, that leaves just three competitors. Nonetheless, most have accepted that limitation and are confident in the pool of candidates.

Other factors stemming from audit regulation and the state of the audit market provide further constraints. The requirement that audit firms refrain from providing non-audit services to audit

clients means that firms have to weigh the financial trade-offs of bidding for an audit client. And, audit firms must expend substantial resources on a tender bid. In response, they are raising fees and becoming more selective about which clients they accept.³ Members are feeling the effects of these pressures on the audit profession. One said, *“I had an experience where a firm had higher fees with non-audit services and would not bid for the audit.”* Several other members reporting having the same experience.

Audit committees can increase choice by asking firms that do bid to provide more options for audit teams. One member said, *“At the end of the day there’s only four Big Four firms. Get rid of one, then you have three. We required firms to come up with three teams each.”* This approach could ameliorate the challenge of having too few qualified partners to choose from. As one member reported, *“Many times the partners the firms present are rolling off other mandates anyway. Otherwise, I’d have to take somebody away from another job to work on mine.”* Another member agreed that qualified partners are not always abundant: *“They’re not waiting on the shelf for my company.”*

The tender process and the roles of the audit committee and management

The tender process spans years and places high demands on the audit committee, management, and bidding firms. The audit committee, with management’s assistance, develops a plan for submitting RFPs, developing selection criteria, and evaluating firms and their audit teams. The most critical component is the audit committee’s evaluation of the firms and partners.

Initiating a tender

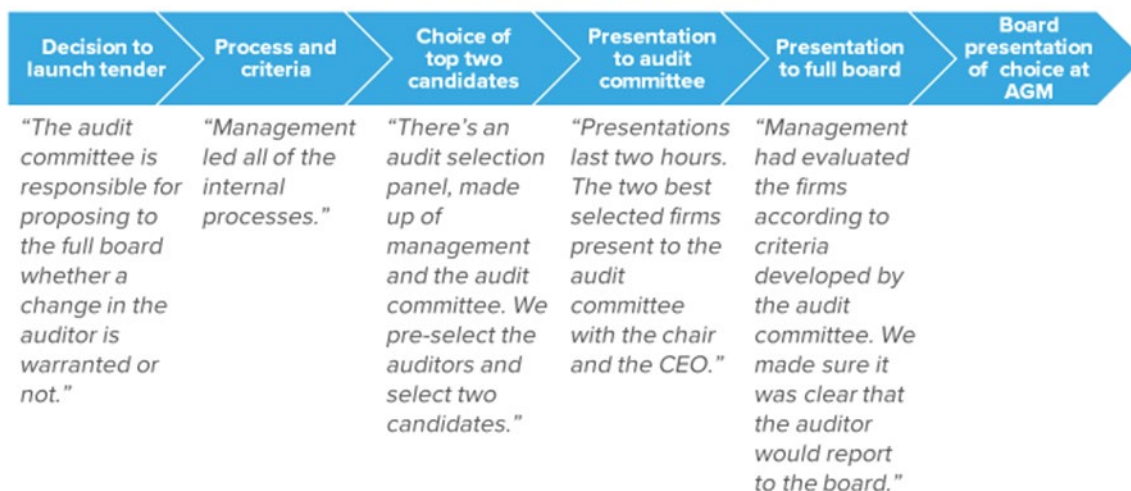
Once the audit committee recommends to the full board that a tender is warranted, it may take years to complete. At the end of the process, the audit committee must present two choices and a “duly justified preference for one”⁴ to the full board.

A key timing consideration concerns “clearing” audit firms to tender, as audit firms are prohibited from performing non-audit services for the tendering company for 12 months prior to the commencement of the audited year, also known as a “cooling-off” period.⁵ Companies rely on advisory engagements that can sometimes take months or even years to wind down. It is critical to devise flexible plans that incorporate realistic timelines for winding down these projects if the firm providing those services is selected as the auditor.

The tender timeline

The following timeline, with comments from audit chairs who have recently been through tenders, highlights some of the high-level steps:

Audit tender timeline



The role of the audit committee

EACLN members were emphatic that the audit tender is the audit committee's responsibility. *"The audit committee should be clear with management right from the start that it's their decision,"* a member said. The audit committee has the lead role under the ARD, and exercises authority throughout the tender, in large part to maintain independence in the selection process. Audit chairs observed that if top executives like the chief financial officer (CFO) were to exercise too much influence on the selection process, the selection might reflect a process which did not neutrally evaluate firms and audit teams on the merits. *"If we have management take control and put it on a plate,"* a member said, *"it reveals an almost subconscious bias. When you have a bias about the sector, for example, then every answer in the questionnaire gets half a point more [in the evaluation calculation]. We changed certain parameters to prevent bias. Management is not always objective."*

The full board is less involved throughout the process; the audit committee will typically keep it apprised of progress on the tender, involving the full board in key moments of evaluation and selection. *"After the audit committee put together recommendations, we involved the chair of the board. He had a conversation with the two lead partners. Then we brought it to the full board with our recommendation. The full board went along with it, as expected,"* one member reported.

The role of management

EACLN members said that management does provide valued substantive input in the process. Audit committees seek key managers' perspectives on firms, partners, and technologies. The CFO and the chief accounting officer in particular can provide a helpful perspective for the audit committee and instill confidence that the auditor will work well with management once the engagement begins. One member said, *"The most important input comes from the chief accountant. He works with the external auditor on a daily basis. And the auditor's technical capability is an important element in the evaluation."* Another member agreed that *"we have to use the expertise of management in evaluating the tender. In the end we sit in the same boat."*



Members shared that management also handles much of the administrative work at the audit committee's direction. Management's responsibilities may include drafting RFPs for the audit committee review, preparing information for bidding firms, bringing partners and internal stakeholders together in meetings, and planning and structuring evaluations. "You couldn't do this alone," a member said.

Conclusion

The audit tender is one of the more demanding tasks an audit committee faces. Because of the mandatory firm rotation requirements of the ARD, the process now occurs more frequently at large European companies. In a tender, audit committees face the difficult task of choosing from among a limited field of highly competent and motivated firms. To meet this challenge, audit chairs are doing more to understand the technology that affects their companies' audits, while also looking for experienced, trustworthy audit teams that will work well with their companies.

About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisors as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, management, and advisors who become systematically engaged in this dialogue, the more value will be created for all.

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European Audit Committee Leadership Network



EACLN



VIEWPOINTS

Appendix 1: List of participants

EACLN members participating in all or part of the meeting included the following:

- Werner Brandt, Siemens
- Aldo Cardoso, Bureau Veritas
- Carolyn Dittmeier, Generali
- Eric Elzvik, Ericsson
- Renato Fassbind, Nestlé and Swiss Re
- Margarete Haase, OSRAM Licht
- Liz Hewitt, Novo Nordisk
- Dagmar Kollmann, Deutsche Telekom
- Helman le Pas de Sécheval, Bouygues
- David Meline, ABB
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- Alan Stewart, Diageo
- Charlotte Strömberg, Skanska
- François Thomazeau, Bolloré

North American Audit Committee Leadership Network (ACLN) members participating in all or part of the meeting included the following:

- Chuck Noski, Microsoft and Booking Holdings

EY was represented in all or part of the meeting by the following:

- Ute Benzel, Germany, Switzerland, and Austria Regional Managing Partner
- Jean-Yves Jégourel, EMEIA Assurance Leader
- Julie Teigland, EMEIA Area Managing Partner

Appendix 2: Discussion questions for audit committees

- ? Why might your audit committee consider an audit tender before legally required?
- ? How far in advance should the audit committee begin planning for a tender?
- ? What role should management play in the tender process? How can the audit committee ensure that it maintains control of the process and does not delegate too much to management? Which managers have expertise that could be useful to the audit committee?
- ? How would an audit firm's technology affect your company's audit? How could firms distinguish themselves using technology?
- ? What would you look for in a lead partner and a Number 2? How would lead-partner rotation affect your evaluation of a particular bid?
- ? Considering your company, its industry, and where it operates, does limited choice of external auditors present a problem? Are there enough qualified firms and partners available?
- ? What role should price play in your evaluation of bids? How important is it that the proposed scope is realistic and that fees remain consistent and predictable?



Endnotes

¹ Simon Dekeyser, Ines Simac, and Marleen Willikens, “EU Statutory Audit Reform, Impacts on Costs, Concentration and Competition,” Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, April 2019, 76.

² The European Audit Committee Leadership Network comprises audit committee chairs of leading global public companies with over \$10 billion in revenue. This document reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

³ Tabby Kinder, “UK Accountancy Firms Prepare to Cull Risky Clients,” *Financial Times*, August 7, 2019.

⁴ Regulation (EU) No 537/2014 of the European Parliament of the Council of 16 April 2014 on Specific Requirements Regarding Statutory Audit of Public-Interest Entities and Repealing Commission Decision 2005/909/EC (2014) OJ L158/77.

⁵ Regulation (EU) No 537/2014 of the European Parliament of the Council of 16 April 2014 on Specific Requirements Regarding Statutory Audit of Public-Interest Entities and Repealing Commission Decision 2005/909/EC (2014) OJ L158/77.