

## The audit tender process

Audit tenders have become more frequent in Europe, in part due to the European Union's Audit Regulation and Directive (ARD). The process can be complex and time-consuming for audit chairs, who often play a lead role. On 1 December 2022, Tapestry Networks convened members of the European Audit Committee Leadership Network (EACLN) to hear perspectives from audit chairs of large, global companies about how to manage audit tenders, as well as the key criteria that boards use to assess firms. EY leaders Marie-Laure Delarue, global vice chair, assurance, and Julie Linn Teigland, managing partner for Europe, the Middle East, India, and Africa (EMEIA), added insights from an audit firm's perspective.

This *ViewPoints* covers key themes that were raised in the meeting and in premeeting conversations on three primary subjects:<sup>1</sup>

- **The benefits and challenges of audit tenders for global companies** (page 1)
- **Implementing an effective tender process** (page 2)
- **Determining evaluation criteria** (page 4)

For a list of meeting participants, see Appendix 1 (page 7); for a list of reflection questions for audit committees, see Appendix 2 (page 8).

## The benefits and challenges of audit tenders for global companies

A complete audit firm rotation can consume several months of a board's time, and overseeing the process is a complex, resource-intensive task. But audit firm rotation can bring benefits, members said, including fresh perspectives, insights into new audit technologies and tools, and heightened awareness about the audit process itself. One member reported being initially doubtful about a tender's usefulness, but then changed his views: *"We made the decision to do a rotation even though it wasn't mandatory. I was coming from the perspective where rotation means something is wrong. But the richness of the process was surprising. It was like a consulting job done by the firms, with their perspectives and insights on the company that the audit committee benefitted from."* Another agreed: *"Although they can be painful, you do learn a lot. It is good for the audit committee because it gives a different perspective and higher degree of assurance."*

EACLN members also pointed out challenges with the audit tender process that continue to concern them:

- **Large European companies and their subsidiaries are subject to different regulations.** There are 13 different audit firm rotation regimes across 30 European countries, including some where tendering is mandatory, but firm rotation is not.<sup>2</sup> This wide range of regulations

can have significant implications for companies operating within multiple jurisdictions, adding operational challenges and increased costs. One audit chair said, *“Out of the six countries that we operate in, two require us to change auditors this year. We currently have one auditor, so do we change it up or split the audit and have a firm handle just two of the countries, or find another firm to do all of them?”*

- **Companies have a limited choice of qualified auditors.** Few firms have the skills and networks to audit a large, global company. For the most part, this has led EACLN companies to choose the largest global firms—typically Deloitte, EY, KPMG, and PwC, known as “the Big Four”—over smaller or local audit firms. But audit chairs described situations in which firms are either unable to tender because they are rotating out, or reluctant to tender because they want to preserve consulting relationships that would be threatened by auditor independence restrictions. This can leave a board with proposals from only two firms, or even one. As one audit chair said, *“When you’re an international company with so many operations, you need a global network. You essentially have a choice of only the Big Four. One of the firms may be going out, and you may be conflicted with another firm because they do too much advisory for you, so if you’re lucky, you have two candidates left ... It is very frustrating.”*

To ensure competition and choice, in some cases audit chairs have made it known that they would end consulting relationships if a firm failed to tender for an audit. *“In a situation where a firm has initially declined to tender because they want to keep the consulting work, I have said, ‘If you don’t tender seriously, we’re blacklisting you on the consulting.’ We’ve had to have some pretty tough conversations,”* one said. Many members would willingly engage smaller audit firms—and, in France, the requirement for public companies to appoint joint auditors has helped to increase opportunities for smaller firms—however, it remains a challenge, as these firms generally lack the worldwide networks that EACLN company audits require.

- **Incumbent audit firms may face a higher bar.** In instances where companies are required to conduct a tender but not to rotate firms, some members felt that they would be likely to retain their current auditor. But Ms. Delarue and Ms. Teigland noted that companies often wind up making a change. One member observed that *“the incumbent is in a difficult position to say how they will improve, because the company will ask, ‘Why haven’t you been doing that already?’”* This means the incumbent firm needs *“to change the dynamic in a way that is unencumbered by the past,”* the member suggested.

## Implementing an effective tender process

Every tender requires substantial time and commitment from both the companies and audit firms involved. Years can elapse between initiating the tender and having a new auditor on board. Many EACLN members have experienced multiple audit tenders, both as non-executive directors and as executives. They shared recommendations to help ensure a smooth process and an effective outcome:

- **Plan ahead and look holistically at the process.** Changing auditors is a significant undertaking. Several years prior to any requirement to tender or to rotate, audit chairs should consider factors that could impact timing. For instance, one company had recently changed both its audit committee chair and its chief financial officer (CFO), *“so we agreed that it was not the best time to open a tender process.”* Audit committees should assume that an effective tender process will take 18 to 24 months, according to members and EY leaders. *“Then you need another year to see through the transition period,”* one added. Starting the process well in advance can enable the company to clear any independence issues and have a wider selection of audit firms.
- **Identify the relevant stakeholders and make role assignments clear.** Audit chairs, audit committee members, boards, and management all play a role in the audit tender process. Making sure all participants are clear on their assigned roles and expectations is an essential first step.
  - **The audit committee.** The audit committee is responsible for presenting its preferred external auditor option to the board for final approval. Audit chairs typically play a prominent role in the tender process, working closely with management on the day-to-day efforts. *“It is a big commitment from the audit chair,”* a member reflected. Audit chairs should ensure that the full audit committee is involved. *“I was part of the process completely as audit chair, but in hindsight, I realize I wasn’t updating the committee enough—that was a lesson learned,”* a member said. Others agreed and noted similar experiences. *“It is essential that the whole audit committee is involved in all discussions, because it is a critical decision on who you will work with,”* one said.
  - **The board.** The full board is typically less involved in a tender, but the audit chair will share periodic progress reports. In some cases, boards review the selection criteria before the process begins. Once the audit committee selects its preferred firm, board approval is sought as the final step.
  - **Management.** The CFO and finance team play a vital role in a tender’s success, ensuring a smooth process, managing logistics, and performing administrative tasks. Companies may appoint a project manager or team to streamline this work even further. Members of the finance organization typically perform preliminary work, subject to audit committee review, such as drafting the request for proposal and preparing information for bidding firms. Most audit chairs stressed that management’s perspectives, especially the CFO’s, are essential. However, one member described a process that excluded the CFO, showing that elements of management’s involvement may vary: *“There is a team supplied by management that supports a very detailed, high-quality process with a lot of pre-work done, but it excludes the C-level and C-minus-one level of management for independence purposes.”*
- **Be efficient, consistent, and creative with interviews.** Members shared several good practices that can be incorporated into the interview stage:
  - **Present a crisis simulation or technical challenge.** This can be an effective means of assessing candidate firms in a dynamic, realistic way. One member inserted a

simulated challenge just before the final presentation: *“Collaboration during a crisis is important, and we wanted to see how they react and work with the team ... It was very interesting to see the firms’ approaches and who they engaged. They came back with very different responses.”* The exercise provided the audit committee with insight into both the technical competence of the firms as well as how the audit team worked together.

- **Incorporate site visits.** Several members described doing site visits to get a sense of how audit teams would function in different localities. *“I went on site visits with the audit team and the CFO. We went to Europe, Asia, and the Americas.”*
- **Consider briefing all candidate firms together.** One member described holding an open meeting with all candidate firms. This was efficient and ensured the company provided consistent information to all candidates. *“We also wanted to see how the firms engaged together and wanted them to see who they were competing with,”* the member said.
- **Allow sufficient time for the transition between audit firms.** Members reported different experiences with audit firm transitions. Some feared that institutional knowledge would be lost or that the move would be exceedingly difficult. While the time and attention required from both the audit committee and management should not be underestimated, several members reported that their audit firm transitions were easier than expected. *“As an audit committee, we were concerned it would be disruptive, but overall, it was a very smooth transition,”* one said. Audit committees can also use the onboarding process as an opportunity to dig deeper into improving audit quality. A member explained, *“The new audit team comes in, and it is their chance to put the issues on the table. Ours came in with a series of issues that had been latent in the company that the prior auditor had allowed to remain in place. That was very positive.”* EY’s Ms. Delarue agreed: *“Take this as a real opportunity to change, to have fresh people, fresh eyes, fresh perspectives. It will very much benefit the quality of your audit.”*

## Determining evaluation criteria

Agreeing on selection criteria is critical for efficiency and clear decision making throughout the tender process. While it can be difficult to identify differences between firms, members said that establishing a company’s highest-priority criteria can help determine important distinctions and ultimately ensure audit quality.

In advance of a tender process, audit committees should seek input on criteria from stakeholders who will have a relationship with the auditors, such as the CFO, the head of internal audit, and other finance leaders. One member described a good practice for this: *“At the beginning of the process, we did a workshop with the audit committee and other members of the work team. We spent several hours determining our criteria and discussing how to prioritize them. I think we had 96 items. It was a very detailed list, like a thesis.”* This enabled the company to run a smooth tender and reduce disruptions.

Several criteria stood out as important for almost all EACLN members’ companies:

- **Independence.** Independence requirements should not be overlooked. *“You have to avoid all conflicts of interest, and that is why we put so much pressure on the independence issues,”* one member said. Ms. Delarue noted, *“Some companies can underestimate what may trigger independence issues, so it is not a zero-risk process.”* Companies that work with multiple firms for audit or consulting engagements may need to ensure that engagements terminate in a timely manner and allow for at least two firms to participate in the tender process.
- **Geography and industry expertise.** For large, global companies, an audit firm with the right regional presence and industry expertise is critical. *“Understanding their experience is important. Do they have a network in the countries that you need? Very often firms will have a presence in the US and Europe, but expertise in African and Asian countries can be more difficult to find,”* a member observed. *“You must ensure your auditors are aware of what is happening with regulations and other issues in the countries where you operate.”*
- **Audit technology.** Technology is critical for defining, planning, and executing audits, and members reported that *“technology and data analytics were big distinguishing features”* in their tender processes. However, major investments in technology made by the Big Four firms in recent years have made it increasingly *“hard to distinguish”* between them. When audit contenders demonstrate how technology will be used, audit committees and other internal stakeholders gain a better understanding of how it contributes to audit quality. Members reported a variety of ways in which they solicit this information. One said, *“I asked them to organize a learning session on what their data analysis capabilities were. I invited my colleagues and management to attend. We had a demonstration that acted as a proof of concept and was very revealing.”* Another described supplying real data to *“see how they would apply technology to our specific audit, not just what their tools are.”*

Audit chairs said they look favorably on firms whose technology offers the company added value. One said, *“Our audit firm was not using their data analytics to benefit the company. They were using it to run the audit in the background. In the tender process, we saw what other firms were doing with technology to apply it not just to the audit but to improve business processes.”* Audit committees should look for how technology *“can be applied not just to the audit and used as a control tool, but for continuous improvement in the business.”*

- **Lead partner and engagement teams.** Audit chairs assign significant weight to the qualifications and capabilities of the proposed audit team and lead partner. It is *“the main differentiator apart from data analytics,”* one member said. *“Reputation, the ability to work together, and the character of the lead auditors”* are crucial, members said. They highlighted soft skills like communication, integrity, and team leadership. But assessing the quality of a team can be challenging and subjective. *“I usually ask for references, because even in a big firm, it very much depends on who you're dealing with. You don't want someone who is afraid of having opinions,”* one advised.

A history of working together can be a positive indicator. *“In one tender, the real differentiator was team spirit,”* a member said. *“It was clear that one team had worked*

together. They listened to each other and interacted in a way that you would expect of a team. The other firm had individually very talented members, but they had never worked together.” Others agreed, with one sharing an experience where “there was some friction between the US and UK partners that led to some issues after they won the tender.” One member noted that audit committees can ask for a new team if they are not confident in the one presented during the tender process. “If you don’t like the team, you have the right to change it.” Ms. Delarue and Ms. Teigland concurred and emphasized that “excellence should be your expectation.”

- **Environmental, social, and governance (ESG) capabilities and other emerging skill sets.**

ESG capabilities are becoming increasingly important, especially as assurance expectations for sustainability and nonfinancial reporting continue to evolve and many audit chairs expect a future with integrated reporting. “The audit firms’ capabilities and approach to nonfinancial reporting was a big block of criteria,” a member said. Another added, “We asked them about ESG, especially in the nonfinancial audits, and whether they were able to incorporate ESG criteria.” Beyond ESG, members are also looking ahead to assess if auditors have the right skill sets to navigate new challenges facing global companies. “Are they aware of challenges coming in the next five to 10 years? Can they assess a risk cartography from a present and future standpoint?”

- **Fees.** Most members do not consider fees a major criterion and stressed that audit quality is the top priority. “The fee is usually tendered at the end of the process. We were agnostic to it and chose who we believed was the right firm. It wasn’t a deciding factor; it was just an additional data point,” one said. Many agreed with the approach of considering it toward the end of the process and only having the audit chair step in if an issue came up that needed to be resolved. Regarding fee assessment, one member described a good practice where the audit firms were asked to submit fee information to the CFO, who reviewed the fees for any major discrepancies: “The audit committee received input from the CFO that there were no insurmountable fee differences and that they should select whichever firm was best. So, the audit committee was not involved or biased by any commercial aspect of the proposal.”

The competitive nature of the industry encourages firms to set realistic fees, but members recommended asking the audit firms to provide information on the “seniority of team members, expected time spent, and the final fee number” as a good practice to understand what the fee is based on. Agreeing on an appropriate fee at the beginning of the audit is important because “if you accept a certain level of fee and then have to go through endless renegotiation discussions, it can be damaging,” Ms. Delarue noted. Members also acknowledged that labor shortages in the audit profession and the wider corporate world are putting pressure on salaries that could impact audit fees in future years.

## 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 advisers 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, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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## Appendix 1: Participants

The following EACLN members participated in all or part of the meeting:

- Julie Brown, Alumna
- Aldo Cardoso, Imerys
- Ana de Pro Gonzalo, STMicroelectronics
- Liz Doherty, Novartis and Philips
- Byron Grote, Tesco and Akzo Nobel
- Dagmar Kollmann, Deutsche Telekom
- Pilar López, Inditex
- Benoît Maes, Bouygues
- John Maltby, Nordea
- David Meline, ABB
- Karyn Ovelmen, ArcelorMittal
- Nathalie Rachou, Veolia
- Maria van der Hoeven, TotalEnergies

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

- Marie-Laure Delarue, EY Global Vice Chair, Assurance
- Julie Linn Teigland, EMEA Managing Partner, EY



## Appendix 2: Reflection questions for audit committees

- ? When was the last time you participated in an audit tender process? When do you next expect to do so?
- ? Why might your firm consider an audit tender before it becomes mandatory? When should companies consider a tender, even if not required to do so?
- ? 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?
- ? What criteria are most important for your audit committee when selecting an auditor?
- ? In what ways do you think selection criteria could change in the next few years? What may grow in importance? What may become less important?
- ? How might an audit firm's technology affect your company's audit? How can firms distinguish themselves using technology?
- ? What do you look for in a lead partner and engagement team? Would you hesitate to consider reengaging your incumbent audit firm?
- ? What role should price play in your evaluation of bids?
- ? What has been most helpful to you in ensuring a smooth and successful tender process in the past?
- ? Does limited choice of external auditors present a problem for your company? Are there enough qualified firms and partners available?

## Endnotes

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<sup>1</sup> *ViewPoints* 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.

<sup>2</sup> Accountancy Europe, *Mandatory Rotation of Auditors – Streamlining European Countries' Audit Rules* (Brussels: Accountancy Europe, 2022), 4.