KPMG

EU audit reform

Four observations about auditor selection

Audit Committee Institute

Making the recommendation to the board on the appointment, reappointment and removal of the statutory auditor has for many years been a fundamental audit committee responsibility. Nevertheless, the recent audit reforms introduce legally binding requirements in the EU in relation to audit tendering and rotation that for most audit committees will represent a significant change to their role. Multinational groups outside the EU should consider the extraterrestrial impact of the EU requirements.

The proposals make the audit committee explicitly responsible for the auditor selection procedure and incorporates a number of detailed procedural matters. Specifically, unless the company qualifies as a small or medium-sized company or is a company with reduced market capitalization, the audit committee must:

1 Ensure that the tender process does not in any way preclude the participation in the selection procedure of firms which received less than 15% of the total audit fees from public-interest entities in the Member State concerned in the previous calendar year (essentially non-Big 4 firms).

In the absence of any further guidance, perhaps the safest course of action is to put advance notice of any tendering plans into the public domain either through disclosure in the annual report (see below) or disclosure on the company website.

2 Ensure that tender documents are prepared that allow the invited auditors to understand the business of the audited entity and the type of audit that is to be carried out.

Each invited auditor will have different experiences and existing relationships with the company so it is important to create as level a playing field as possible by providing sufficient information to ensure a fair selection process.

3 Ensure that the tender documents contain predefined transparent and non-discriminatory selection criteria; and that the audit proposals are evaluated in accordance with such criteria.

Prima facia this would appear to remove any latitude for changing the selection criteria once the process has started. Selecting the right selection criteria, in conjunction with all relevant stakeholders, before the process begins, and articulating them in the 'right' way, is therefore essential – and arguably the most difficult part of the selection process.

4 Identify in its recommendation its first and second choice candidates for appointment and give reasons for its choices.

Where the choice of audit firms is limited, it is particularly important to establish as early in the process as possible that all firms are willing and able to accept appointment; or alternatively conduct a tender with sufficient lead time to enable any issues to be managed (i.e., tender two years out); or with some flexibility on timing (i.e., tender for year nine with a backstop for year ten).

For further information on EU audit reform and tendering from the Audit Committee Institute please visit **www.kpmg.com/globalaci**