

Statutory report on the audit tender process

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 a number of legally binding requirements in relation to audit tendering and rotation that for some Public Interest Entity (PIE) audit committees will represent a significant change to their role. Specifically, SI 2016 No. 649 'The Statutory Auditors and Third Country Auditors Regulations 2016' requires that the audit committee be responsible for the auditor selection procedure and, by reference to the EC Audit Regulation, that (unless the company qualifies as a small or medium-sized company) the audit committee shall ensure that a report on the conclusions of the selection procedure is prepared and validated by the audit committee. Similar requirements exist for non-corporate PIEs governed by the FCA and/or PRA rules.

A written report providing the conclusions of the selection procedure is now a legislative requirement. The report is to be prepared by the audited entity (presumably management or those responsible for managing the audit tender on a day to day basis) and validated by the audit committee. It should include the rationale for the selection of the auditor or reappointment of the incumbent auditor.

Also, the audit committee must ensure that the company is able to demonstrate to the competent authorities, upon request, that the selection procedure was conducted in a fair manner. The written report on the selection procedure will be a key document should such circumstances arise.

Other than providing the audit committee with a clear rationale to support their choice of two audit firms and documenting the decision making process - and in providing evidence to the competent authority (FRC) if called upon to do so - it is not clear what other purpose the report is required or intended to fulfil. There is no requirement for it to be made available to investors or the general public, however, some companies have put summaries of their audit selection procedure into the public domain and these have generally been well received – see the example from Barclays PLC [here](#).

Where such documents are put in the public domain, they provide an opportunity to discuss any peculiarities or sensitivities attached to the audit tender process in more detail than might be discussed in the annual report. Such issues might include, for example, the steps taken to secure (and demonstrate) independence where an audit committee member is a former partner of one of the firms being asked to tender. [Note: a number of audit committee chairs who were until recently partners of tendering firms have excluded themselves from the tender process other than providing comments on the initial design of the tender process].

The remainder of this paper sets out a potential structure and a number of questions that might help preparers when producing their report on the selection procedure.

Remember, a UK incorporated entity is a PIE if it either:

- issues transferable securities that are admitted to trading on an EU regulated market;
- is a credit institution (e.g., a bank or building society);
- is an insurance undertaking

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Background

- Discuss the reasons for tendering the audit and why it is in the best interests of shareholders.
- Provide context by addressing the legislative requirements.
- Identify the firms who participated in the tender process.
- Discuss the scope of the audit. (Is it for all group companies or are some subsidiaries excluded?) Disclose the rationale for excluding certain subsidiaries? Were other services tendered at the same time?
- Discuss when the tender process started (the RFP), the conclusion of the process and the date from which the audit firm will take office.
- Discuss the approach to understanding any shareholder concerns.

Governance

- Confirm that that only the audit committee, acting collectively or through its chairman, was responsible for:
 - initiating and supervising the competitive tender process;
 - making the recommendation to the board of directors as to its first and second choice candidates for appointment pursuant to a competitive tender process;
 - influencing the appointment of the audit engagement partner; and
 - negotiating and agreeing the statutory audit fee and the scope of the statutory audit.
- Discuss how the tender process was managed and supported and any particular features designed to ensure the tender process was transparent, fair and effective e.g., data rooms, feedback loops, transparent selection criteria, etc.
- Identify who was involved internally and at what stage of the process e.g., approve the design of the tender process, conduct detailed assessment, etc.
- Explain how any conflicts of interest were managed e.g., the exclusion from the decision making process of individuals who had a recent senior relationship with any of the audit firms.
- Explain any procedures to manage compliance with the group's gifts and hospitality policy and any additional actions such as declining hospitality invitations from the competing firms during the duration of the tender.

Participation

Note: The Regulations require that audit committees must 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 PIEs in the previous calendar year".

- Discuss the steps taken to ensure that, in a UK context, non-Big 4 firms were not precluded from participation in the selection procedure.
- Discuss whether any non-Big 4 firms were approached and whether they actively participated in the tender process.
- Discuss any advance notice of any tendering plans put in the public domain either through disclosure in the annual report, disclosure on the company website or via the Regulatory News Service (RNS).
- Confirm that there were no clauses restricting the choice of audit firms.
- Discuss whether the audit committee considered a choice of potential audit partners from each firm so they could choose the partner who is the best fit.

Note: The Regulations require that tender documents are prepared that allow the invited auditors to understand the business of the audited entity.

- Discuss the steps taken to ensure the tender documents included sufficient information to enable the invited auditors to understand the business and the type of audit that is to be carried out.
- Discuss the steps taken to create a 'level playing field' recognising that each invited auditor will have different experiences and existing relationships with the company.
- Summarise the information provided to auditors and the mechanism by which it was shared e.g., data rooms etc.

Evaluation process

Note: The Regulations require that the tender documents contain transparent and non-discriminatory selection criteria that shall be used to evaluate the proposals made by the auditor; and that the audit proposals are evaluated in accordance with the predefined selection criteria.

- Summarise the pre-defined non-discriminatory selection criteria e.g., audit approach, proactivity, organisational fit, commitment, etc.
- Discuss whether the process was 'fee-blind' or not; and why.
- Discuss any 'disqualifying' criteria i.e., criteria which if met would mean the firm in question would be eliminated from the tender process. For example: the inability to achieve independence before a given date; no experience in the given sector or geography; or evidence of persistent serious regulatory breaches. Care should be taken to ensure the criteria are non-discriminatory in substance and in form.
- Discuss the due diligence activities carried out to assess the firms and inform the evaluation against each of the pre-defined selection criteria. For example:
 - Request for Proposal (RFP) covering the firms' experience, proposed solution, independence and transition.
 - Audit quality workshops to assess the firms' knowledge, experience and approach to auditing key accounting judgements, information technology and other matters.
 - Review of regulatory reports on the audit firms from the FRC (and other regulators) over the past 5 years.
 - Reference checks with Board members, audit committee members and management at comparable companies.
 - Site visits to allow assessment of the proposed teams.
 - Try before you buy – assessing the performance of the tendering firms against a technical question or test.
- Discuss how any findings or conclusions of any inspection report on the potential auditors was factored into the selection process.
- Discuss the evaluation approach (scorecards, etc.), who the evaluators were and any 'weighting' applied to the selection criteria such as X% for audit quality; Y% for cultural fit; Z% for experience; etc. Specifically address the involvement of the audit committee.
- Discuss any feedback mechanisms and any steps taken to allow firms to finesse their proposal and provide their best possible audit proposition.
- Discuss how management appraised the audit committee of the results of the evaluation activities.
- Describe the presentation phase. Who presented, how long were the presentations, etc.? Were all audit committee members present? Were management present?

Recommendation

Note: The Regulations require that the audit committee identifies in its recommendation to the board, its first and second choice candidates for appointment along with the reasons for its choices.

- Set out the two firms recommended by the audit committee.
- Identify the audit committee's preferred choice.
- Explain why the successful firm was chosen, including key areas where they excelled.
- Discuss how the transition between the outgoing and incoming audit firm will be managed.

Contact us

Timothy Copnell

Audit Committee Institute

T: +44 (0)20 7694 8082

E: tim.copnell@kpmg.co.uk

www.kpmg.co.uk/aci

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