

The future of assurance

The practicalities
of audit rotation



Building a better
working world



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Viewpoint

The new EU audit legislation means that a lot more Public Interest Entities are going to be organizing audit tenders over the coming years. Having participated in a significant number of tenders over the years, we've got strong views on how they can be managed most effectively.

Public Interest Entities (PIEs) are getting to grips with the practicalities of EU reform on audit rotation and the limits on non-audit services, working out their transition plans and strategies for the procurement of professional services and making the critical decision on when and how they should tender.

The scale of the reform means there are huge practical implications on planning and managing the process of audit rotation.

“It’s critical for organizations to decide their key buying criteria well in advance.”

In summary

- ▶ A question of timing – it’s vital to start planning an audit tender well in advance of the critical date.
- ▶ Buying criteria – defining your buying criteria should be a joint effort between the audit committee and management.

While some companies are getting on with the job – accelerating the tender process and picking the best teams – others are taking advantage of the transition rules to delay the tender for as long as possible. However, some entities have very little time for transition, and that in itself creates significant risks.

Whichever route is taken, PIEs need to focus strongly on transition risk. Boards, audit committees and investors alike should take a cold, hard look at the strategic issues the tendering process raises. How, for example, can you maximize your choice of auditor? How do you manage independence – for instance, how will you source non-audit services (NAS)?

Independence can’t be achieved in a day. Making sure that the auditor is independent

can be a major challenge for PIEs, as well as being at the core of auditor objectivity. Many PIEs underestimate how difficult it can be to ensure that all services provided are fully compliant with the terms of the EU legislation.

A question of timing

Experience on recent tenders suggests that, if they can, PIEs should allow at least 18 months before the formal audit tender begins, in order to manage independence properly. This window enables everyone to plan the transition properly.

The new EU rules have specific prohibitions for the year in advance of appointment. They provide for a “cooling-in” period, i.e., the prospective audit firm cannot provide statutory audit services to



a client if it has been involved in specific activities in the prior year: designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information, or designing and implementing financial information technology systems.

In those countries where mandatory periodic audit rotation has already been introduced, companies have, over time, become increasingly acquainted with the process and conditions. More and more are building data rooms and helping to share information between audit firms to allow the tender to proceed.

Buying criteria

It's critical for organizations to decide their key buying criteria well in advance. Are sector skills key, for example, or is it the experience of the lead partner?

Defining these criteria will be a joint effort between the audit committee members and management, because it's important that everybody has a voice at the beginning of the process. While management will run

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Isabelle Santenac and Hywel Ball on audit rotation



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the tender on a day-to-day basis, the audit committee should be in agreement from the start about the key buying criteria and what will shape the selection process, which it will be responsible for initiating, managing and overseeing. It will ultimately recommend one of at least two auditors for the board to propose to shareholders for approval.

Make sure you allow yourself enough time to conduct a thorough process, as the more time spent in advance of the pitch, the better the chances of getting the right team.

Above all, make sure lines of communication are clear and both the executive management team and the non-executive level understand where responsibility and accountability lie. The importance of this cannot be underestimated, because when the non-executive directors on the audit committee are going to make the recommendation for selection, with that recommendation comes accountability.

They will have to get themselves involved early enough in the process, and must be able to demonstrate that the process was conducted in a fair and transparent way. Shareholders will probably question the selection process, to ensure it was robust enough to select the best auditor for the firm in question.

Selection is an important issue for investors. In some cases, we encourage clients to reach out to these stakeholders, to see what they think about the process. This is introducing a fresh dynamic into the audit market, but one that is likely to figure increasingly prominently in future.





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In France, for example, where there has been a proliferation of tenders over the past 20 years, we have found that the tender process is becoming more thorough as a consequence of the interaction between audit committees and management, as well as growing investor interest. Increasingly, the process is a trilateral one and, as a result, more comprehensive – a true

win-win. There may be lessons here for companies in other countries.

In time, auditors and businesses alike will doubtless become much more efficient in how they approach and manage the audit rotation process. The goal is to ensure high-quality audit, which is so vital not just to individual PIEs, but to the efficient functioning of the capital markets.



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