

All change in external audit

*Managing your audit arrangements in a period of great change...
... and how Independent Audit & Risk Review can help you*



THE AUDIT MERRY-GO-ROUND, AS IMPROVED BY RECENT REGULATORY INTERVENTION

INDEPENDENT
AUDIT & RISK REVIEW



All change please

Companies are bowing to the inevitable. Over the next few years there are going to be an awful lot of audit tenders. Most of them will result in changes.

When is a good time to change auditors? Most CFOs will say there is never a good time, just a less bad time. Just holding a tender is a laborious and time-consuming process. Actually changing is even more of a pain. And the road is strewn with independence pitfalls.

Did you know... that in 2013 at least one FTSE 100 company tried to change auditors and then discovered – too late – that it couldn't actually appoint the firm it had picked, while others found themselves running rather uncompetitive tenders? All because they hadn't realised how hard it would be for non-audit service providers to make themselves independent.

And if you decide the right time isn't now, you'll need to think hard about how to explain to shareholders that they don't have to exert themselves about the audit quality and independence. The annual effectiveness review has to play a part.

Yes you can *must*

So it's important to choose the right time for your tender, and even more for an eventual change. Unfortunately there are lots of forces all trying to limit your choice, all in different ways:

- EU rules, uncertain in timing and extent but likely to bring new independence restrictions and rotation requirements
- Competition Commission mandatory tendering requirements – completely unnecessary if the EU rules come into force, of course, but there is no historical precedent for regulation being held back just because it's unnecessary
- Auditing standards requirement for audit partners to be rotated every five years
- FRC requirement for “comply or explain” tendering to coincide with the partner rotation
- Investment firms joining the proxy agencies in starting to get (over)excited about audit firm tenures
- Audit firms who can't (or won't) bid because their non-audit services are too entrenched (or too valuable)
- Few audit firms with the necessary industry expertise or geographic capability
- Competitors who jump in and change auditors ahead of you so they can “get the best engagement partner”.

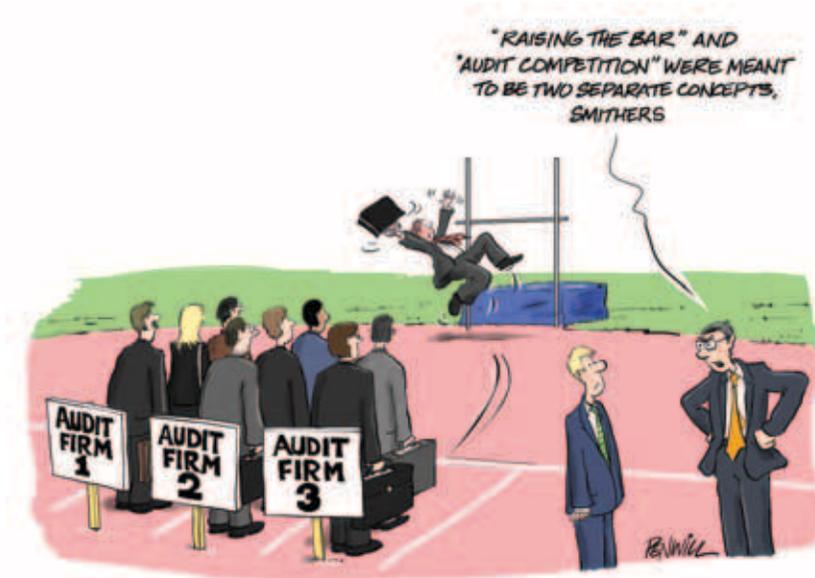
All in all, it's a bit of a mess.

Regaining control

There are several ways we can help you regain control of your audit arrangements amongst all this noise.

- 1 Helping you set a timetable that's right for the business
- 2 Raising the bar for the incumbent
- 3 Making the tender process easier

...and in the process increasing the Audit Committee's credibility with investors.



Managing the timetable

Our contacts with investors suggest that most of them take a pretty pragmatic approach. They have a general preference for change after extended tenures, but understand that things like finance transformation projects, major acquisitions and disposals, and limited choice of audit firm can be good reasons for postponing. Although there are the usual few (but noisy) zealots who can't hear anything except their own shouting, most investors will listen to an audit committee's explanation. Their main requirement is that it needs to be a credible explanation.

We can help make your explanation more credible by undertaking an independent review of the effectiveness of the external audit process for the audit committee. In fact, we're about the only people with a high level of professional experience in this who aren't conflicted.

Audit partner rotation can be deferred for up to two years at the audit committee's request – if it's necessary to protect audit quality. This is a hard bar for an audit committee to clear. It's a lot easier with our expert advice behind it. (Sorry, if you're SEC-registered you can forget this bit.)



Raising the bar

For the last ten years, audit committees should have been assessing the effectiveness of external audit. For most companies, that meant asking the finance director how it had gone this year.

As an approach, this worked pretty well when no-one was taking any notice. But in the last year or two a couple of things have changed. One is that audit committees have to give much fuller reports of what they've actually done – just restating the terms of reference is no longer enough. The other is that, having been prodded by the Competition Commission, the big investment houses are showing increasing signs of interest in the audit committee report. It isn't yet up there with the remuneration committee report, but – even before advisory votes on audit committee reports come in – it's already moving on rapidly from the days when all an audit committee had to do for a quiet life was keep the non-audit fees down.

We carry out independent reviews of the effectiveness of the external audit process for audit committees. We take a qualitative approach that complements the more procedural approach to audit quality taken by the audit firms and their regulators. The outcome will be advice to the audit committee on whether it's in shareholders' interests to reappoint the incumbent, advice to the company on how to make itself a better client, and advice to the audit firm on how to improve their service quality.

The combination of our expert advisors with our online service **Thinking Board** means that we have a cost-effective solution for every size and shape of company, from smallish domestic ones to huge multinationals. Our clients tell us that not only do they have a better story for the audit committee to tell in the annual report, but also that the relationship with their auditors has been strengthened.

And a further benefit of our review is that it will set a benchmark and help you clarify the requirements for your RFP, when you get to that stage.

The tender process

The Competition Commission made it very clear that the audit committee has to be responsible for the selection of audit firm, including the selection process. That's all very well in theory, but in real life non-executive directors rarely have the capacity to get very involved in the process. They need to delegate the work, and that creates its own problems.

- Professional service procurement is often the Achilles heel of procurement departments. Even if yours is one of the rare exceptions, it will almost certainly have no experience of auditor selection and no knowledge of all the regulatory baggage that comes with it. (Some usually-competent companies have found themselves put into embarrassing situations by this.)
- Group finance has knowledge and experience which will, to a large extent at least, be relevant. Since group finance functions are always flat out they won't have much spare capacity for managing the process, but they will probably manage somehow to make enough time available because they have such an interest in the outcome. And therein lies the problem: it's too easy for the cynic to caricature this as the burglar being invited to choose the policeman.
- Secretariat and internal audit are the only other possibilities, assuming they have capacity. But secretariat has little or no expertise in auditor selection, and even though internal audit might – don't take it for granted – they have their own axe to grind when it comes to external audit.

We can help you conduct an effective and efficient tender. We bring two main things to help address the typical problems: independence and expertise. Both bolster the audit committee's confidence in making its decision and in reporting it to shareholders, while our challenge and expert advice helps management with the process. In addition, we are able to step in and carry some of the load if internal resources are over-stretched.

Tender support in practice

We can't predict exactly what sort of help would be most useful to you, but we can guess that it will include one or more of these, to a greater or lesser extent.

- Forming a clear definition of your audit tender objectives – do you know exactly what you want from your auditors? Better to set it out clearly from the outset than to be vague and then grumble afterwards
- Identifying which firms to invite and which business units to include in the tender
- Ensuring that all the independence issues and practical constraints have been identified, and the consequences for the timetable and the long-list of candidates properly considered
- Defining, collecting and managing the tender data
- Creating an RFP document that will result in the sort of proposals that you actually want to receive, rather than the sort that the audit firms want to send you
- Managing audit firm questions and requests for meetings with management, ensuring there is enough opportunity to test personal chemistry and culture fit without management's entire lives being taken over by auditors' charm campaigns
- Objective, professional evaluation of the proposal submissions that helps you to strip away the froth and find out what the real differentiators are
- Balanced appraisal of the pros and cons of each of the bidders
- Planning the transition if you decide to change.

Our experience and credentials

We really understand external audits – but we don't do them. So we're in the rare, maybe unique, position of being experts in audit without having an axe to grind or external audit services to sell.

We understand how audits are regulated and how they work in practice, having been on the "auditor" side at senior levels. We know how they're planned, what happens when they're executed – and how the audit firms organise themselves. We know what makes audits work well and what stops them being effective – including all the little ways in which companies can make themselves unnecessarily difficult clients. And when it comes to tenders, we've worked with them before and know what to look out for.

We also see audits from the other side – your side. We work with lots of audit committees through our leading position as reviewers of board and committee effectiveness and see how audits are working in other businesses. What's more, we have experience of chairing audit committees ourselves, and of being on the receiving end of audits. So we understand what the audit committee and management need from audit and the practical realities of the relationships.

Our experience of advising on external audit effectiveness and tenders runs around the world and across all sorts of industries, including heavily regulated ones. And our online evaluation service **Thinking Board** means that even companies with the largest, most geographically diverse audits have been able to benefit from its unrivalled analysis at a surprisingly modest cost.

IT WOULD BE POLITICAL
TO GET THIS FIXED



Contact

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