



Federation of European Accountants  
Fédération des Experts comptables Européens

# Auditor selection

Towards best practices



October 2013





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## FOREWORD

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Companies are changing their auditors more frequently than in the past, in response to market and other demands. As a good selection process is essential if there is to be **a transparent selection that enhances audit quality and ensures auditor independence**, FEE took the initiative to reflect and propose ways in which the process of selecting an auditor can be performed most effectively.

This FEE publication could be of use to:

- ✓ Companies seeking guidance on how to manage the auditor selection process in an efficient and cost-effective way; and
- ✓ Stakeholders, such as shareholders and investors, in assessing a company's current selection process.

This publication is intended to be **generic**: it is applicable irrespective of the regulatory environment, country, sector (either public or private) or industry. It is also applicable to companies of all sizes in all market segments – e.g. public-interest entities (PIEs) and small and medium-sized enterprises (SMEs). However, due to the diverse legal frameworks and governance structures across Europe, the reader may also need to refer to local company law and corporate governance requirements.

FEE is committed to fostering the public debate in this regard. As a first step, FEE sought the views of all stakeholders in an online survey conducted between 24 May and 31 July 2013. The outcome of this survey is attached as an appendix to this paper.



*Tip: When this icon appears next to a section of this paper, this means that it is supported by the results of the survey conducted by FEE.*

## INTRODUCTION

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FEE aims to share best practices for a high-quality process when selecting the auditor in the applicable environment. FEE is eager to participate in the debate in order to pursue the following goals:



- ✓ Creating a more transparent and informed auditor selection process;
- ✓ Ensuring an appropriate focus on the **quality of the audit**; and
- ✓ Contributing to the selection of an **auditor who is independent**, in accordance with applicable laws and regulations.

This raises two important questions to which answers will have to be found in the selection process in accordance with the company's specific circumstances: **what is audit quality?** and **what is the value of an audit?** Although there are currently a number of studies on audit quality, to respond to these questions, one may refer to an important project by the IAASB<sup>1</sup> to develop a framework for audit quality<sup>2</sup>. **The quality of services and its value to the client and to all stakeholders, as well as the need to establish appropriate interactions amongst stakeholders that will enhance audit quality, should be the 'leitmotiv' when selecting the auditor.**

The process can be divided into the following steps (explained in more detail below):

- ✓ Information-gathering before the selection;
- ✓ Pre-selection of the auditors/audit firms to be invited to participate in the selection process;
- ✓ Development of criteria to select the auditor/audit firm; and
- ✓ Ranking the importance of each criteria previously developed that will help review, analyse and assess the applications of the candidates.

Principles of project management should be applied to this process, and it should be up to an **auditor selection panel** to be responsible for leading and overseeing the whole project.

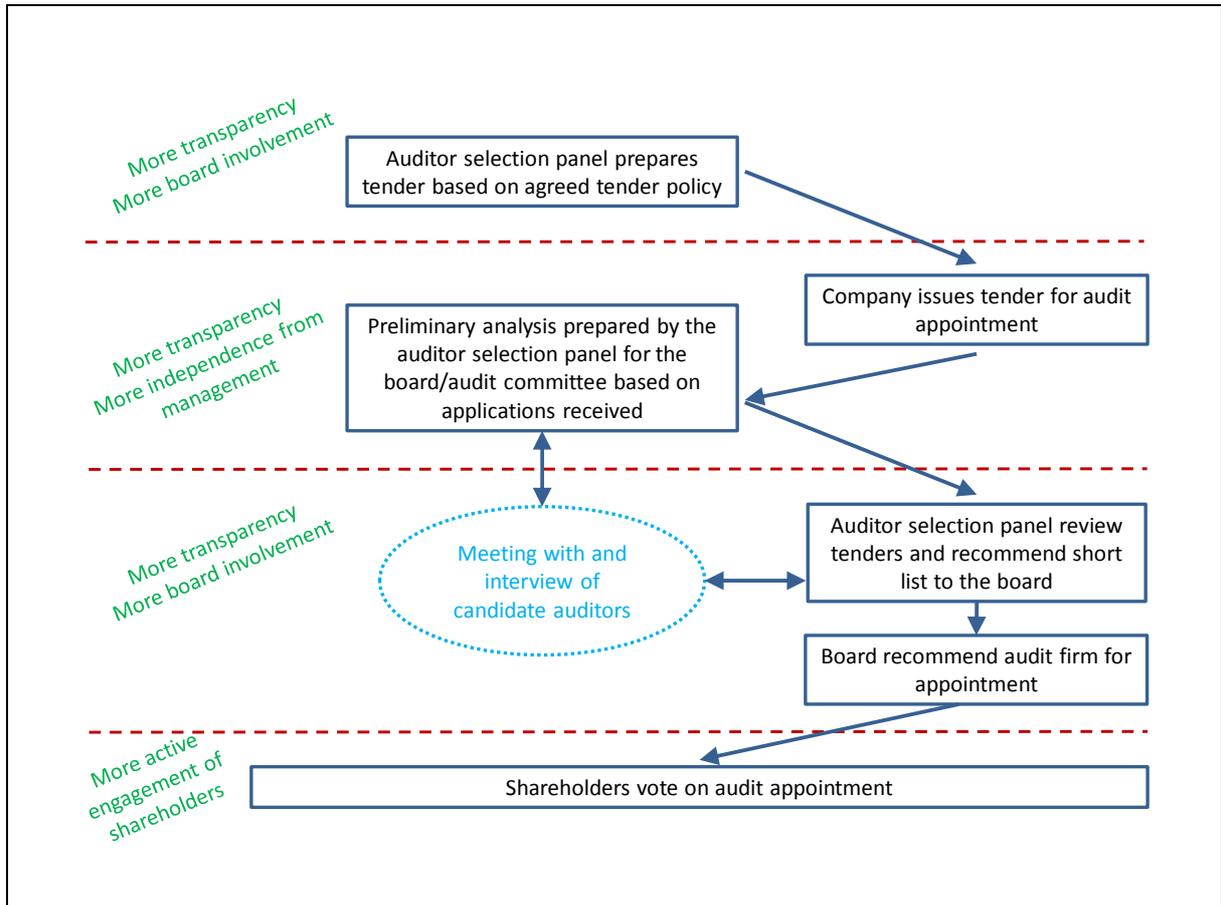
**Who is the auditor selection panel?** Depending on European/national laws and regulations, the auditor selection panel may be composed of audit committee members, supervisory board members and/or shareholders. Management could also be involved where appropriate – e.g. in a consultative role or in an SME environment. The auditor selection panel should be the body accountable for such a project.

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<sup>1</sup> International Auditing and Assurance Standards Board

<sup>2</sup> More information is available at: <http://www.ifac.org/publications-resources/glance-framework-audit-quality>

The proposed phases that a company might follow are detailed in the diagram below:



The last step of the decision-making process referred to above – i.e. the shareholders' vote – **is not addressed in the paper.**

## FIRST STEP: INFORMATION-GATHERING BEFORE THE SELECTION

### Governance aspects of the appointment of the auditor

From a legal perspective, the auditor is formally **appointed/elected by the shareholders of a company or by others charged with governance of an entity**. The formal appointment is usually based on the recommendation of the board or the audit committee.



See analysis of Q1

Depending on the jurisdiction, the appointment of the auditor may be for a multiple-year period or for a single-year period. Successive reappointments are permitted in most jurisdictions.

#### *For PIEs*

The auditor is bound by ethical standards governing independence and, while the audit firm can remain appointed for some time, PIEs' key audit partners are required under EU law to rotate after a maximum period of seven years and cannot participate in the engagement again for two years<sup>3</sup>. Different measures may be needed for companies of differing types and sizes.

In general, the process for the selection and appointment of the auditor should be **independent of management**. The entity's governing body – for example a board of non-executive directors or a supervisory board – should be responsible for decision-making.

#### *For non-PIEs*

Non-PIEs are a less homogenous group. The need to involve independent members of the board – or the audit committee, if applicable – could be relevant for large non-PIEs. For smaller unlisted companies, including SMEs and companies with an owner-manager structure, it could be beneficial if the directors and shareholders become more involved in the process.

To enhance the quality of the selection process, FEE recommends the following:

- ✓ **Definition of needs:** the needs of the company should be defined in accordance with: corporate-governance regulations, rules, codes and best practices (where relevant); the market segment; the business; the type of internal organisation; the expectations of relevant external stakeholders; etc.
- ✓ **Establishment of an auditor selection panel:** it should be up to an auditor selection panel to lead the process of selecting the auditor. Nevertheless, balanced cooperation and interaction with the management should be in place in order to achieve a selection that is fit for purpose. As is already the case in some EU member states, **non-executive directors are best placed to be part of this panel**. In general, it should be emphasised that independent members of the board, members of the supervisory board or members of the audit committee should be more frequently involved in and be responsible for recommending the selection. This would ensure that the appointment of the auditor is independent of the management of the entity.

<sup>3</sup> According to Directive 2006/43/EC on statutory audit (currently under review)

- ✓ **Transparency:** there should be enhanced disclosure and transparency of the auditor selection process. In particular, reports by the board or the audit committee should include the rationale for the selection of the auditor/audit firm or the renewal of an incumbent audit firm's term. Audit firm transparency reports, mandatory within the EU for all firms auditing PIEs<sup>4</sup>, are useful tools for the auditor selection panel, as they provide useful information on the auditors/audit firms – e.g. structure and governance, system of quality control, financial information, list of main clients, etc. These reports are publicly available on auditors'/audit firms' websites.
- ✓ **Shareholder involvement:** the auditor selection panel should seek to engage with the shareholders in the process, for instance by involving a shareholders' nominating committee, if possible, depending on national laws and regulations.



## Is there a role for the procurement department?

**The auditor-company relationship is more than a pure buyer-seller one.** There are obvious similarities with the purchase of any other service and, for instance for public sector entities in the European Union, the Directive with regards to public procurement<sup>5</sup> has to be applied. However, the specificities of the relationship between the auditor and the client have to be taken into account: it is a unique relationship, as the benefits and contributions go far beyond the company level only. The auditor has a duty towards relevant stakeholders. By way of the auditor's report, the auditor brings trust, which:

- ✓ Enhances the credibility and reliability of the company's financial statements; and
- ✓ Gives stakeholders – such as shareholders, employees and investors – more confidence in the company.

For these reasons, the selection process should not be left solely to the procurement department of the company, whose decision to 'purchase' might not be based on an overall assessment of all the necessary criteria, as for instance the ones described hereafter.

<sup>4</sup> According to article 40 of the Directive 2006/43/EC on statutory audits (currently being revised)  
<sup>5</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:134:0114:0240:EN:PDF>

## SECOND STEP: PRE-SELECTION OF THE AUDITORS/AUDIT FIRMS TO BE INVITED TO PARTICIPATE IN THE SELECTION PROCESS

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### Determining the needs of the company

As explained above, to pre-select the auditors to be invited to tender, **the auditor selection panel has to determine the company's needs**. Indeed, one standard selection process cannot suit all companies. To do so, the **primary objectives** should be well defined before starting the process. These objectives may include:

- ✓ Complying with regulation or corporate-governance best practice;
- ✓ Improving the service;
- ✓ Assessing the current audit approach;
- ✓ Testing the market.

**One may also reflect on whether it is the right moment for the company to initiate this process.** Timing can indeed be sensitive: it is often not ideal to change the auditor when the company is undergoing major external and/or internal changes – for instance, if the company is completing a significant acquisition transaction or is itself targeted for potential acquisition, if the company has launched an IPO, etc.

### Independence of the auditor/audit firm

Candidate auditors should be able to demonstrate **their independence, objectivity and commitment to ethical behaviour**. The pre-selection of the auditors/audit firms to be invited in the tender should be made with these key features in mind. The auditor selection panel should seek a **letter of representation** that includes information on **whether the auditor is independent** of the company **and how the auditor monitors and maintains his/her independence**. In this regard, a review of the provision of audit-related services and non-audit services by the candidate-auditors/audit firms in the past years, as well as of their potential business relationships with the company and/or its management should also be performed by the auditor selection panel to **pre-select the participants in the process**. This will have to be carefully examined as, depending on the circumstances, the provision of such audit-related and non-audit services may or may not impair the auditor's independence for the future provision of audit services.

## THIRD STEP: DEVELOP CRITERIA TO SELECT THE AUDITOR/AUDIT FIRM

The evaluation criteria set by the auditor selection panel should be **transparent**. An equal and fair chance of selection will therefore be ensured for all participating auditors/audit firms, and in particular where the incumbent auditor is invited as well. In addition, a transparent process will help outside parties such as shareholders, investors and regulators **assess the process**.



Depending on the needs and objectives defined by the auditor selection panel in the previous steps of the process, the evaluation criteria may include the following:

- ✓ **Approach to business and operations in general and in relation to specific engagements, audit approach and communication strategy**
  - **Approach to business and operations in general**
    - Business model and governance of the audit firm;
    - Internal processes to ensure independence and other relevant rules are correctly applied;
  - **Audit approach**
    - Description of the methodology to be used by the auditor;
    - Areas that will receive primary emphasis and the audit approach in such areas;
    - Comprehensive work plan to ensure an adequate coverage;
    - Business understanding;
    - Industry-specific experience, if applicable;
    - Use of IT tools;
    - Use of associated or affiliated member firm personnel and third-party experts, if necessary.
  - **Communication strategy**
    - Additional internal status report, in which the auditors can for instance outline weaknesses in internal controls;
    - Means put in place to ensure the timeliness of the information;
    - Policy regarding the availability of partners and managers for miscellaneous (telephone) inquiries and short meetings throughout the year.
- ✓ **Reputation:** a good and ethical reputation has to be demonstrated by the auditors/audit firms in the selection process. The evaluation of such a criterion is not straightforward, but it is of the highest importance. Requesting references may help in this evaluation.
- ✓ **Evidence of audit quality**
  - **System of internal quality assurance:** the auditor selection panel needs to understand the basic elements of the auditor's system of internal quality assurance based on the auditor/audit firm presentation and available documentation;
  - While however often not publicly available, the auditor's/audit firm's individual inspection reports are a part of the evidence to be taken into account when considering audit quality.
- ✓ **Assessment of the individual auditor/audit engagement partner**
  - The auditor selection panel should be able to meet the individual auditor/audit engagement partner(s) put forward to be in charge of its entity's audit engagement. The panel will be able to assess whether they meet the professional expectations about the firm as anticipated in the tender documents.

- ✓ **People management**
  - **Qualification**
    - Audit qualifications of the team members;
    - Involvement of experts on specific subject matters, such as tax services, actuarial services, etc. Such involvement will enhance audit quality depending on sector specificities.
  - **Training**
    - Continuing professional development (CPD).
  - **Experience**
    - Engagement partner's expertise and knowledge;
    - Appropriate level of seniority of team members and effective contribution at the relevant level;
    - Informed audit team with international outreach, when necessary, for the good conduct of the audit;
    - Relevant industry experience and expertise of the audit firm and/or the audit team.
  - **Availability**
    - Availability of the engagement partner;
    - Staff continuity, i.e. staff turnover records from previous years.
- ✓ **Geographical coverage:** not all engagements will require wide geographical coverage, but it would be important for audits of multinational entities.
- ✓ **Auditor's/audit firm's insurance coverage** should be assessed as compliant with what is required by local legislation or justified by the needs of the business, the sector and the circumstances.
- ✓ **Pricing (i.e. audit fees)**  
The audit contract should be awarded on the basis of the most economically advantageous offer, not the lowest price. By taking this strategic approach, companies can ensure that they do not compromise the quality of the audit.

To identify the most economically advantageous offer, the auditor selection panel should assess the audit fees against:

- The availability of the key members of the team and the resources of the auditor/audit firm as a whole;
- The personnel resources, their expertise and qualifications;
- The allocation of personnel, i.e. hours to be spent allocated to each type and level of qualified resource<sup>6</sup>; and
- The risk approach and the audit methodology – these can indeed have a significant effect on pricing on both sides (e.g. gain in efficiency, use of experts, site visits, etc.).

Reasonable fees should be determined to ensure that the audit is carried out in an efficient and effective manner and that the audit team is well equipped to perform the audit to high standards.

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<sup>6</sup> According to a recent IFAC article, professionals should no longer be focused on timesheets and billable hours, but on the intellectual capital they bring to their clients. The full article can be accessed at: <http://www.ifac.org/news-events/2013-02/tomorrow-s-firm-and-role-value-pricing>

- ✓ **Relationship management and interpersonal skills**
  - This criterion is principle-based, but there may be key attributes that help the auditor selection panel evaluate the relationship management, the objective being to differentiate auditors/audit firms during the selection process. Different dynamics have to be taken into account depending on whether the auditor/audit firm applying seems to have compatible personal skills and background with the entity as a whole;
  - The auditor/audit firm applying is able to demonstrate capacity in building objective, independent and transparent working relationships with the management team and task forces, as well as with those charged with governance.

These attributes will be instrumental in achieving an audit of utmost quality. One may refer to the meaningful concept of 'professional working relationship'<sup>7</sup>. A good relationship and positive attitude are not indicative of a lack of independence or conflict of interest on the part of the auditor: the right balance has to be struck between **professional scepticism** and **cooperation**.

- ✓ **Capacity for innovation**
  - The auditor should be able to demonstrate his/her ability to improve the audit processes, for instance through the use of technology;
  - These tools can help the auditor to be efficient and effective in his/her audit work. This efficiency can serve the company, helping achieve a more in-depth or better analysis, despite the fact that one may have some concerns that IT tools could encourage a 'tick-box' approach.

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<sup>7</sup> Reference is made to the IAASB publication 'A Framework for Audit Quality' where professional scepticism is emphasised, whereas interactions are crucial between all parties involved in the reporting chain.

## IN A SNAPSHOT: LIST OF POSSIBLE CRITERIA

### Approach to business and operations

- Business model and governance of the audit firm
- Internal processes

### Audit approach

- Proposed methodology
- Areas that will receive primary emphasis and the related audit approach
- Comprehensive work plan
- Use of associated or affiliated member firm personnel and third-party experts

### Business understanding

### Industry-specific experience

### Use of IT tools

### Communication strategy

- Additional internal status report
- Policy regarding the availability of partners and managers for miscellaneous telephone inquiries and short meetings throughout the year
- Means to ensure the timeliness of the information

### Reputation

- Good ethical reputation
- References

### Evidence of audit quality

- Within the audit firm: review of the system of internal quality assurance
- External information: review of the auditor's/audit firm's specific inspection reports

### Assessment of the individual auditor/audit engagement partner

### People management

- Qualification & training
- Experience
- Availability

### Geographical coverage

### Auditor's/audit firm's insurance coverage

### Price

- 'Value for money'
- The availability of key team members
- The personnel resources, their expertise and qualifications
- The allocation of personnel, i.e. hours to be spent allocated to each type and level of qualified resource

### Relationship management and interpersonal skills

### Capacity for innovation

- Ability to improve the audit processes, for instance using technology
- Tools to be more efficient and effective in the audit work

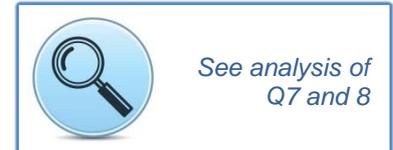
## FOURTH STEP: RANKING THE CRITERIA

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As explained above, different criteria will have to be taken into account when performing the evaluation. Some may be easy to measure (**factual criteria**), while others may be more subjective (**soft-skill criteria**, which are dependent upon the perceptions of the auditor selection panel members or the context). The evaluation of these criteria is likely to be different from one entity to another. They include for instance:

- ✓ **Factual criteria:** sectoral knowledge, technical capabilities, audit firm geographical coverage, etc.
- ✓ **Soft-skill criteria:** the personal characteristics of the audit team members, the communication skills of the engagement partner, etc.

**Not all of the criteria listed above are strategic for all entities.** Their importance varies depending on the company. The auditor selection panel will need to assess which criteria are:



- ✓ Of the utmost importance;
- ✓ Important;
- ✓ 'Nice to have'; and
- ✓ Not applicable, depending on the company to be audited.

In the framework of these categories, once a consensus has been reached amongst the members, the panel will have to develop a model of ranking and a scorecard to assess the auditors/audit firms applying. The model will have to be applied to all applicants and will depend on the structure and specificities of the company.

## HOW TO PREPARE FOR AN AUDITOR SELECTION PROCESS

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Good preparation is essential to safeguard the effectiveness of the process. The few tips below may help in the preparation of the process:

- ✓ The auditor selection panel should take into consideration that it is a procedure that is likely to be **time-consuming**.
- ✓ A step-by-step procedure should be put in place: the auditor selection panel should **manage the process with robust and proportionate project-management techniques**.
- ✓ The auditor selection panel should understand the audit process itself.
- ✓ In the documentation made available to auditors/audit firms invited to tender, the auditor selection panel should be **explicit** about what the primary objectives are and what the company expects from the tender.
- ✓ With regard to the auditors/audit firms to be invited to tender, some practical matters have to be tackled, including:
  - Should the incumbent auditor be invited to tender? This will depend on whether the selection takes place in the framework of a tendering process, a mandatory rotation or a necessary rotation following the required resignation of the auditor – because of new circumstances that affect independence, etc. If the incumbent does participate, specific attention should be given to creating as level a playing field as possible.
  - How many auditors/audit firms are to be invited? Because of time constraints, FEE would recommend that no more than six firms be invited to tender.
  - For the short list, two would be an adequate number. (This would depend on the initial number, however.)
- ✓ An open-book approach should be taken, so that the same information is available to all auditors who participate in the process within the applicable ethical and confidentiality framework.

When organising the selection process, the panel should raise the following questions:

- What kind of information **should** be shared with the pre-selected auditors/audit firms? How?
  - What kind of information **should not** be shared?
- ✓ The transition of auditors should be planned in advance. In addition, all relevant departments including the accounting and financial departments should be ready to work intensively with the newly selected auditor. After the first year, an assessment of the audit by the auditor selection panel is important to compare the commitments made in the selection process with the work done during the audit. This would also be a good practice for successive years.

## CLOSING REMARKS

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### Preparation is the key to success

In every selection process, there is always a risk that the chosen auditor will not be fit for purpose. For instance:

- ✓ There might be a lack of overall cooperation between the auditor and the company that may prevent the auditor from being able to conduct a proper audit,<sup>8</sup>
- ✓ A disruption in the information flow between the management and the auditor or between the audit committee and the auditor might put working relationships under strain; or
- ✓ A lot of time might be spent in an auditor selection project without achieving the primary objectives.

To mitigate this risk, it is important to plan ahead and to take an approach that suits the company's needs. As demonstrated, **there is value in investing in the project and in selecting the right auditor/audit firm for the company.**

### FEE further commitments

Potential further steps may include:

- ✓ Round-tables to further discuss this subject matter across Europe, seen the overwhelming enthusiasm of the wide variety of respondents to the online FEE survey;
- ✓ A more in-depth survey at EU level with outside stakeholders.

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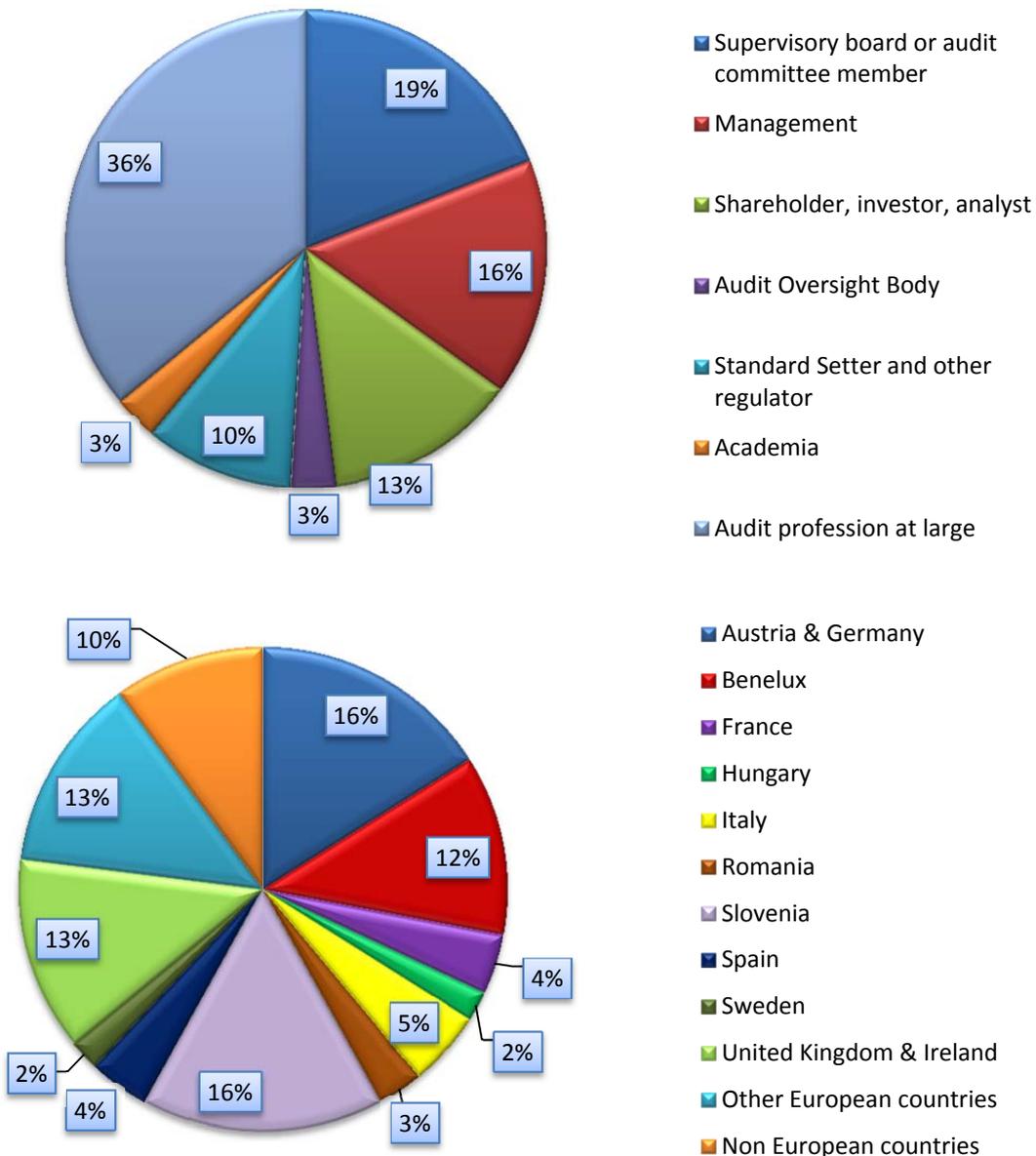
<sup>8</sup> Reference is made to the IAASB consultation paper 'A Framework for Audit Quality' available at: <http://www.ifac.org/publications-resources/glance-framework-audit-quality>

## APPENDIX: RESULTS OF THE FEE SURVEY ON BEST PRACTICES (24 MAY – 31 JULY 2013)

244 stakeholders responded to the questionnaire, 201 of whom provided information on their geographical location and professional background.

The results illustrate their wide range of backgrounds:

*Tip: The categories listed in the legends below are represented in the pie charts in the same order (clockwise from the top).*



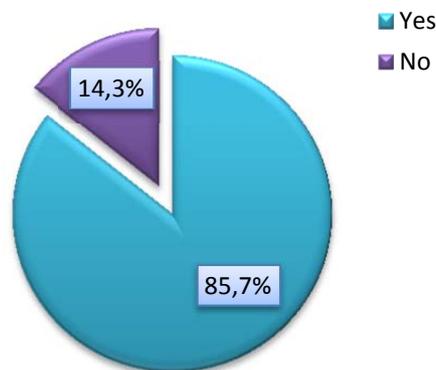
Outreach to other stakeholders resulted in a significant amount of responses from a variety of profiles including: (supervisory) board and audit committee members (19%); management (16%); shareholders and investors (13%), standard-setters and regulators (10%), etc.

36% of respondents were auditors, including auditors of large listed and unlisted entities, auditors of SMEs and representatives of professional bodies.

In addition, the survey attracted respondents from a lot of different countries – including most EU member states and several non-EU countries as well – thus giving more weight to this analysis.

## 1. Should the audit committee be in the driving seat in the auditor selection process?

This question was answered by all 244 respondents, a clear majority of whom – representing 85.7% – indicated that the audit committee should steer the auditor selection process.



Of those who disagreed – representing 14.3% and 35 respondents – 23 felt that it should instead be the shareholders who assume this responsibility. In addition, some respondents volunteered additional comments to this question, a feature that was offered by the questionnaire. This enabled some respondents to nuance their responses and provide some comments with regard to the involvement of other stakeholders in the selection process:

*“In our jurisdiction, the audit committee is part of the Board, and it is up to the Board to formally make a proposal to the General Assembly which ultimately approves the designation of the auditors.”*

*Group Finance Director, large listed entity, France*

*“Where there is no audit committee then the board of directors should be in the driving seat. It could be useful to include the Chief Finance Officer (CFO) in the selection process as they know what they are looking for.”*

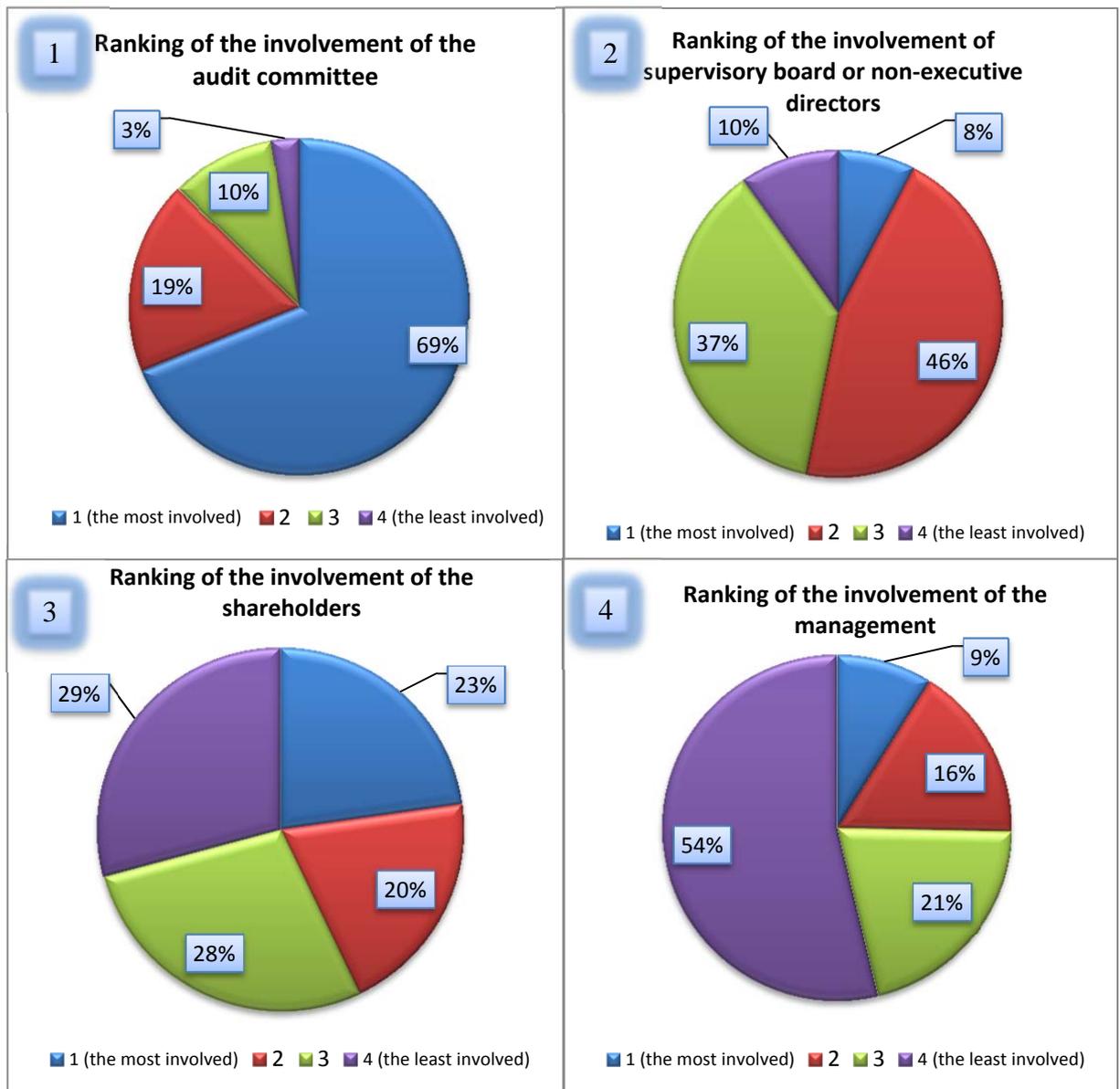
*Accountant in business, UK*

## 2. Please indicate your ranking of the involvement in the auditor selection process for each potential stakeholder

Further to the analysis of the first question, the majority of respondents ranked **the audit committee first** (69% – refer to the first pie chart) and the supervisory board or non-executive directors second (46% – refer to the second pie chart) as far as their involvement in the auditor selection process is concerned.

The involvement of the management or of the executive directors was ranked last by the majority of respondents (54% – refer to the fourth pie chart).

The results with regard to the involvement of shareholders were less conclusive, as it appeared respondents interpreted 'involvement of shareholders' in different ways (refer to the third pie chart).



Here as well, some respondents added comments:

*"[...] With respect to management, [heads of finance, accounting and/or internal audit] have a significant role in assessing the performance of auditors and capacity of candidates as they have first-hand knowledge of the audit process and results."  
Group Finance Director, large listed entity, France*

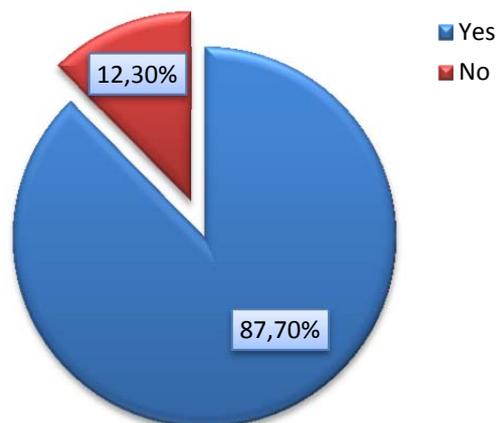
*"Attention [should be given] to minority shareholders."  
Anonymous*

*"[What about the] Chief Internal Auditor?"  
Non-executive director, large listed entity, Italy*

*"[...] Shareholders[...] [should have] the final word in selecting the auditor on the shareholders' assembly, but [the] audit committee and [the] internal auditor are the most involved parties in the selection process – in choosing between candidates on the quality basis."  
Internal audit director in a financial institution, Slovenia*

*"[The] selection [should be made] by the audit committee, [which] formulates [a] proposition to the board. [This proposition should be] approved by [the] shareholders."  
Regulator, EU*

### 3. Would best practices help stakeholders involved to develop a better auditor selection process?



For a large number of respondents (87.7%), best practices would indeed help stakeholders to develop a better auditor selection process.

Respondents provided some interesting comments with regard to the development of best practices, including:

*“Informed stakeholders will have greater understanding of how to select auditors that are best placed to add value to their organisation. Additionally, informed stakeholders will be able to clearly communicate their needs to the tendering auditors, enabling the auditors to tailor their offering to the stakeholders’ needs, thus increasing shareholder buy-in and improving audit effectiveness.”*

*Auditor from a large firm, Spain*

*“There needs to be a healthy regard for national diversity. [A] principle-based framework would be helpful.”*

*FEE member body technical advisor, UK*

*“The importance of nuance in these things should not be underestimated. As in auditing, a checkbox approach is rarely the best way to do things if utilised without additional thought.”*

*Auditor from small practice, non-European country*

*“To have [the] greatest weight, the guidance should be endorsed by shareholder groups and not written by auditors for auditors.”*

*Audit committee member, non-European country*

*“While the audit committee should take the lead role in appointing the auditor, concern exists with respect to the consistency of qualifications and expertise of audit committees across the different jurisdictions. Best practice would help this inconsistency to some extent but efforts also need to be made to recruit the most capable people to audit committee positions across all jurisdictions.”*

*Auditor, UK*

#### 4. Please choose at least five items that best describe your perception of the auditor selection process.

The items to be chosen by respondents were as follows:

<input type="checkbox"/> Fair	<input type="checkbox"/> Well informed
<input type="checkbox"/> Transparent	<input type="checkbox"/> Unstructured
<input type="checkbox"/> Objective	<input type="checkbox"/> Funniest thing I did recently
<input type="checkbox"/> Complex	<input type="checkbox"/> Time consuming
<input type="checkbox"/> Biased	<input type="checkbox"/> None of the above
<input type="checkbox"/> Onerous	
<input type="checkbox"/> Other (please specify)	
<input type="text"/>	

Most respondents indicated that they considered the selection process to be **transparent (59%)**, **fair (53%)** and **objective (53%)**.

However, many of the stakeholders that had recently been involved in a selection process stated that they found it somewhat **complex (61%)** and **time-consuming (54%)**. Furthermore, several respondents described the process as **insufficiently transparent** and/or **too focused on fees**. Respondents also left other valuable comments, including the following:

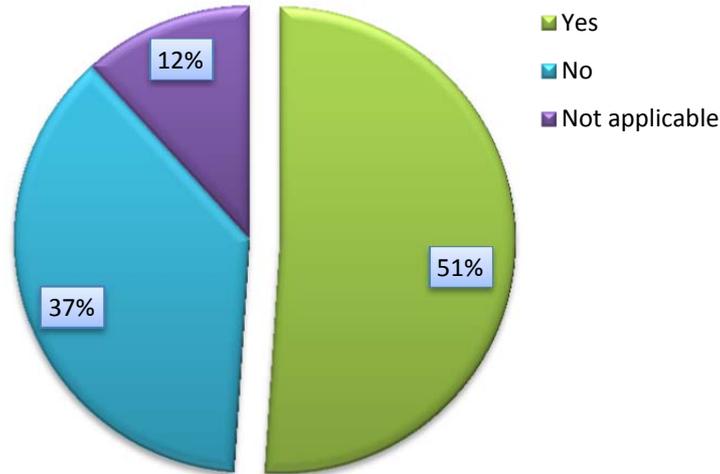
*“There are a number of audit committees [...] [going] through the process for no reason other than “we should have a look around” without any constructive arguments as to why.”*  
Auditor from small practice, UK

*“[The choice] is often limited due to conflicts [linked to independence matters].”*  
Non-executive director of a large listed entity, UK

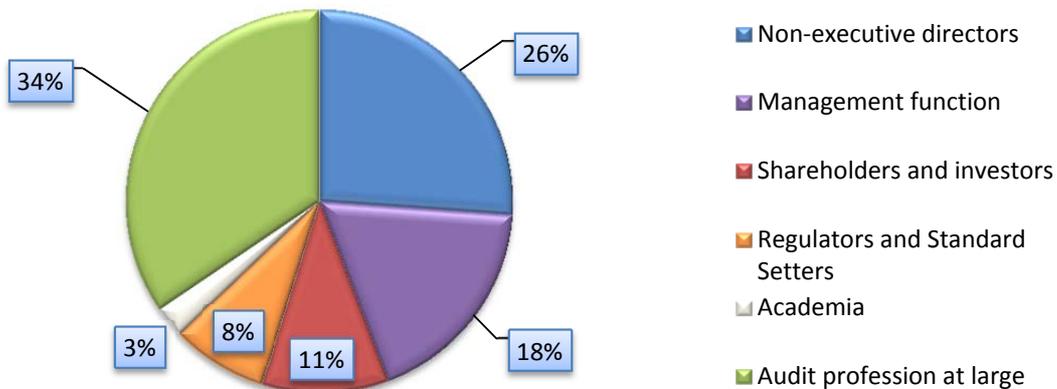
*“The process is as fair and well informed as possible. The difficulty arises from “factualizing” the capacities of existing and potential auditors/audit firms and balancing those with the prerequisite of the lead partner qualities.”*  
Group Finance Director, large listed entity, France

## 5. Have you recently been ‘involved’ (directly or indirectly) in an auditor selection process?

Just over half of those surveyed indicated that they had been involved, either directly or indirectly, in such a selection process.



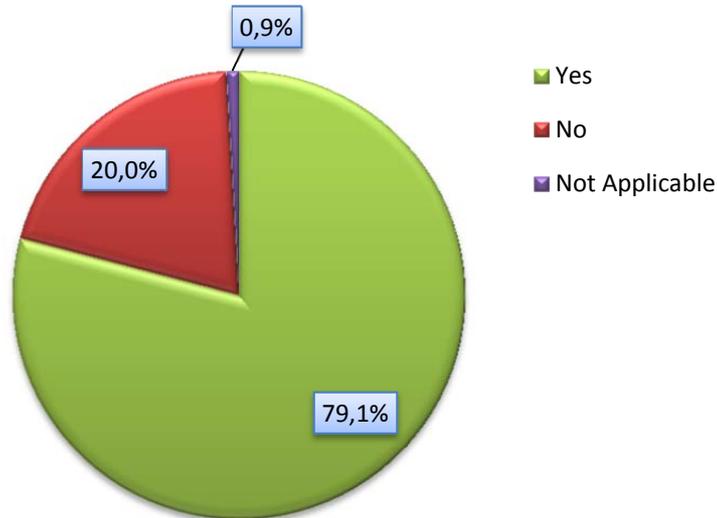
The profiles of the 51% of stakeholders that had recently been ‘involved’ in an auditor selection process are as follows:



Please note that the questions that follow were addressed exclusively to those respondents who had indicated that they had recently been involved in an auditor selection process. The questionnaire was designed in this manner to ensure that any feedback would be based on actual experience as opposed to mere perception.

## 6. Was the procedure of this auditor selection process determined in advance?

Of the 110 respondents who had recently been involved in an auditor selection process, the majority indicated that the procedure had indeed been determined beforehand.



*“I participated in many processes. They were all very different.”*  
Auditor from a large firm, Austria

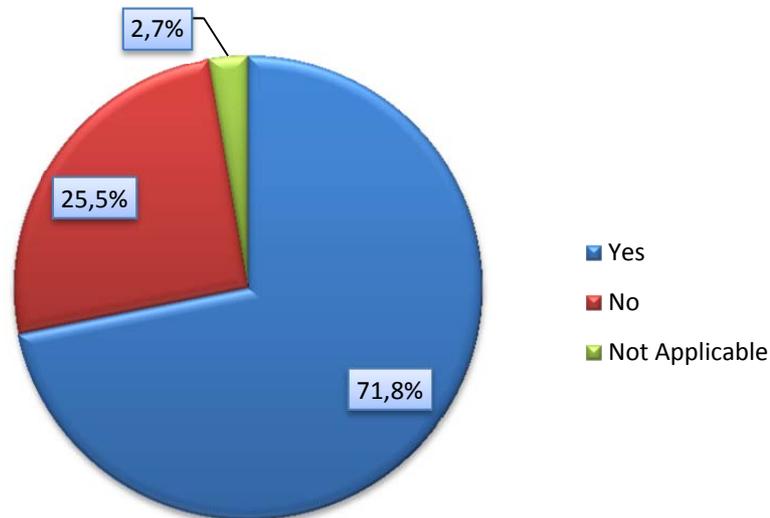
*“At least, most of the time, the criteria are pre-determined. However there are cases when they are not.”*  
Professional organisation, Germany

*“There are continuing concerns about the risk of bias in favour of the biggest firms. There is a challenge for all to ensure that the selection process is balanced and fair.”*  
Audit committee member, UK

*“A proper "homogenization" of the proposals [...] is fundamental in order to compare among the various candidates. [...] [In addition,] The knowledge of what an audit is about should be a need for those involved in the selection process.”*  
Board member in SMEs, Spain

## 7. Were specific criteria set to select the auditor?

79 respondents – representing 71.8% – stated that specific criteria were used.



In this open-ended question, the criteria disclosed by respondents as used to select auditors included:

- ✓ Technical skills, experience and the need for a quality-oriented audit firm/auditor were mentioned by 41 respondents:
  - Ten specifically disclosed business-specific/sectoral knowledge as a must;
  - Two emphasised the fact that the auditors' skills and experience should be in accordance with the company's needs;
  - Five insisted on the fact that quality of services/added-value should be at the centre of the selection criteria;
  - One stakeholder specifically mentioned IFRS skills;
- ✓ Budget / value for money / price were mentioned 29 times, but mostly not as the main criterion;
- ✓ Reputation and references were mentioned 13 times;
- ✓ Team composition was mentioned eleven times;
- ✓ The proposed audit approach was mentioned seven times, with one explicitly mentioning the appropriateness of the risk-based approach;
- ✓ Ten respondents mentioned the need to detect the auditor/audit firm as capable of developing good working relationships;
- ✓ The ability to work under pressure and to deliver on time were also supported by six respondents;
- ✓ The size of the audit firm and its geographical coverage were also mentioned by stakeholders involved in large companies (seven times).

Useful comments were made with regard to the use of criteria and their types including:

*"Independence as such is 'a must'; it should not be a criterion as such."*

*Auditor of large unlisted entities, Belgium*

*"[An important criterion is also the] potential for good cooperation between the auditor, the audit committee and board of directors."*

*Member of a financial market regulator, Denmark*

*"The auditor [may need to be] specialized in the industry in which the company to be audited is engaged."*

*Board member, Spain*

*"The knowledge of what an audit is about should be a need for those involved in the selection process. [In addition] A proper "homogenization" of the proposals from the various candidates is fundamental in order to compare among various candidates. Price should not be the main criteria. Too low prices may affect quality."*

*Non-executive director, SME, Spain*

In addition, a full list of interesting criteria was provided by one respondent:

*"Credibility - internal and external*

*Answer the full question (ATFQ) - answered all questions in tender*

*Team - satisfied with proposed team*

*Approach - satisfied with proposed approach*

*Delivery - do what they say on time*

*Responsibility - drive audit planning, fieldwork and completion & manage audit process*

*Flexibility & creativity - help with issues vs. "Dr. No"*

*Challenge - probe and question*

*Ability - will they cope [?]*

*Availability - client access and response*

*Communication - good news & bad news*

*Relationship - long term vs. fair-weather friend*

*Client importance - will we feel loved after the tender process stops*

*Audit tender process - positives & negatives*

*Unique features - anything different"*

*Group finance director, large unlisted entity, UK*



## 8. Please rank the criteria that you consider to be the most important to select the auditor

FEE proposed a wide range of criteria and asked respondents to rank them from **1 (the most important)** to **8 (the least important)**.

Good reputation on the 'local' audit market
Risk management of the audit firm/auditor in general
Actual or perceived quality of the audit firm
Business-specific knowledge
Geographical coverage
Adequate insurance coverage
Relationship management
Communication skills of the lead partner
Potential for good cooperation between the auditor and company's management
Audit approach and strategy presented
System of internal audit firm quality assurance
Auditor independence
People management, including qualification of the team, training and experience
Availability
Use of experts to assess specific areas of risks
Price
None of the above
Others (please specify)

Those who responded to this question felt that the **most important** criteria were:

Criteria selected	Respondents ranking this criterion as <b>1 or 2 (%)</b>
Actual or perceived quality of the audit firm	33%
Audit firm's business-specific knowledge	32%
Auditor independence	29%
Audit firm's reputation on the 'local' audit market	22%



To a lesser extent, the following criteria were also disclosed as used:

Criteria selected	Respondents ranking this criterion as <u>3, 4 or 5</u> (%)
Potential for good cooperation between the auditor and the company's management	25%
People management, including qualification	24%
Price	21%

The respondents indicated that the **least important** criteria were:

Criteria selected	Respondents ranking this criterion as <u>6, 7 or 8</u> (%)
Audit firm's geographical coverage	24%
Audit firm's availability	23%
Adequacy of the insurance coverage	21%
Use of experts to assess specific areas of risks	21%

FEE would like to thank all those stakeholders who took the time to respond to the online survey. Many of the additional insights provided were of a very high quality and helped us a great deal in developing this paper. FEE is committed to further collaboration with these stakeholders.



## FURTHER READING

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### **FEE member bodies**

Association of Chartered Certified Accountants (ACCA), 'The value of the audit'

Institute of Chartered Accountants of Scotland (ICAS), 'Appraising your auditor'

Institut der Wirtschaftsprüfer (IDW), 'Cooperation between the Supervisory Board and the Auditor'

### **UK Financial Reporting Council (FRC)**

UK Corporate Governance Code: section C3: 'Audit Committee and Auditors' (pages 18 to 20)

Guidance on audit committees: section 'The external audit process' (pages 10 to 11)

Guidance on tenders: 'Audit Tenders: Notes on best practice'

### **International Auditing and Assurance Standards Board (IAASB)**

'A Framework for Audit Quality'

<http://www.ifac.org/sites/default/files/publications/files/A%20Framework%20for%20Audit%20Quality.pdf>

### **US Center of Audit Quality (CAQ)**

'Audit Committee Annual Evaluation of the External Auditor'

### **Other**

Ernst & Young, 'Enhancing transparency of the audit committee auditor oversight process'

KPMG Audit Committee Institute, 'Audit Committee Handbook' – includes a dedicated chapter on the external auditor (pages 92 to 109)

Rosneft Group, description of an audit tender:

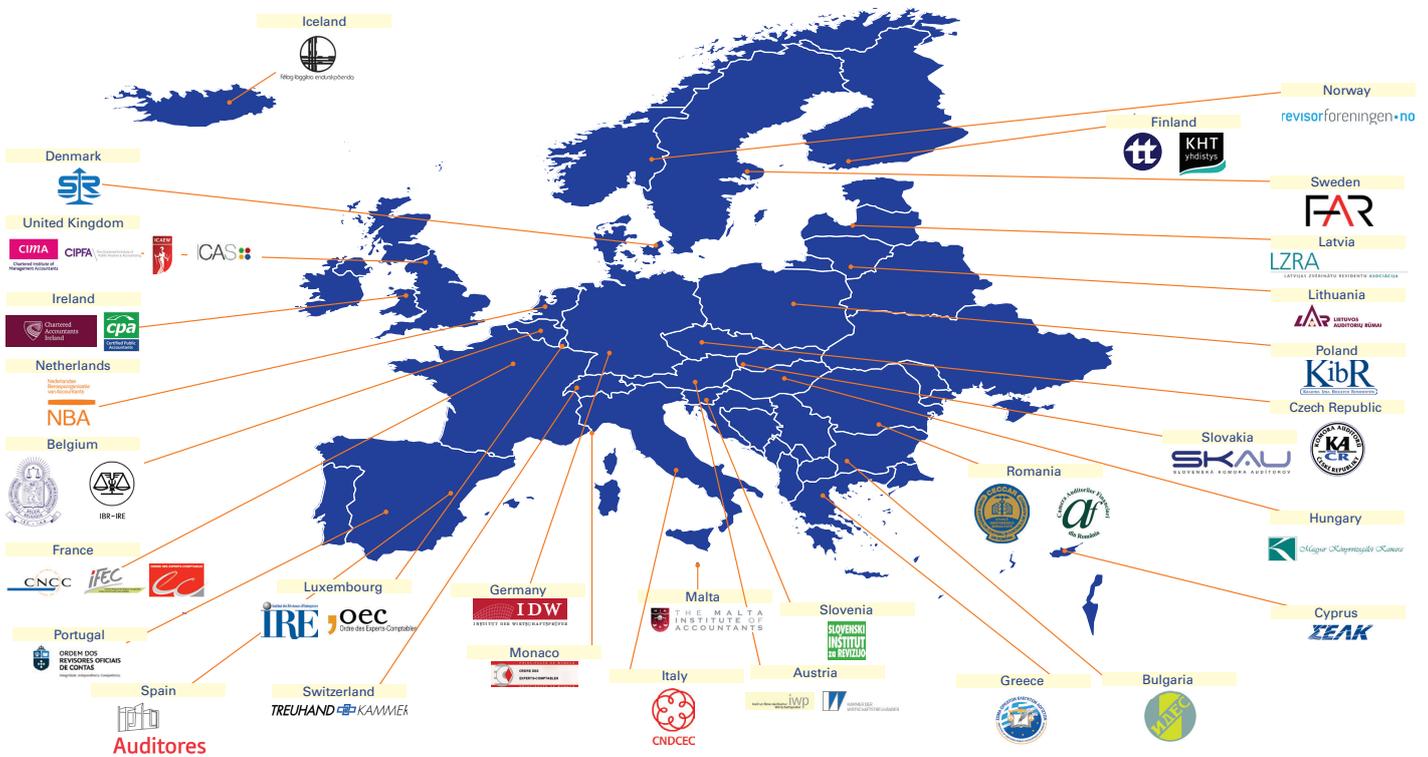
[http://www.rosneft.com/Investors/governance/internal\\_control\\_and\\_audit/auditors/](http://www.rosneft.com/Investors/governance/internal_control_and_audit/auditors/)

## About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 45 institutes of professional accountants and auditors from 33 European countries, including all of the 28 EU member states.

FEE has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and large accountancy firms, businesses of all sizes, government and education – all of whom contribute to a more efficient, transparent and sustainable European economy.

## FEE and its members



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