



Finance and Administration Committee

FAC(19)06

***Information to Inform a Discussion on the
Frequency of NASCO's Audit Cycle***

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In 2012, NASCO decided to change auditors for the first time since its founding. Given the change, the new auditing firm was engaged for a three-year period to ensure costs would remain stable. This practice has continued since. Our current auditing firm, Saffery Champness, has indicated that three years is generally quite a short time period for an audit cycle and has asked us to consider the benefits of extending our cycle in line with the Institute of Chartered Accountants' guidelines on best practice. That document is included herewith, and I would draw your attention in particular to the highlighted section on page four, an excerpt of which states: 'Many public sector organisations are subject to regulatory requirements for tender frequency, with 5 years being a common appointment period. There is a balance to achieve the benefits of rotation yet avoiding a rotation period which is so frequent that it incurs unnecessary cost and reduces the efficiency of the audit, particularly in the first year where the auditor has to get to know the client.'

In light of this information, the FAC may wish to consider the utility of extending the current audit cycle of NASCO, which ends in 2020. If any change is agreed, therefore, it would apply when a new decision is taken on the appointment of an auditor at the 37th NASCO Annual Meeting.

Secretary
Edinburgh
22 May 2019



SELECTING YOUR AUDITOR

A GUIDE TO TENDERING THE EXTERNAL AUDITOR
APPOINTMENT FOR PUBLICLY FUNDED, THIRD
SECTOR AND NOT-FOR-PROFIT BODIES

APRIL 2018

1. INTRODUCTION

This guide has the following sections:

1. Introduction

- Purpose and who can use this guide
- Why it is a good idea to evaluate and tender audit services

2. Summary of the audit tender process

- Why and when to tender
- Organisation - auditor relationship
- Auditor independence
- Key assessment criteria
- The tender process

3. A step by step guide - detailed questions on audit tendering

1.1 Purpose and who can use this guide

This guide aims to help those in any publicly funded body including education, housing and registered social landlords, arms-length organisations delivering public services, the third sector and other not for profit bodies. Whilst focused on those who are responsible for the audit tender process it is also relevant to those participating in national audit frameworks.

The aim is to identify and apply good practice whatever the mechanism for appointing auditors. The principles apply across different jurisdictions in the UK and to any type of publicly funded organisation. It is primarily focused on those responsible for tendering the external statutory audit in the executive/senior management team and audit committee members/equivalent.

It can also be used by local government councillors involved in the appointment of auditors to arms-length external organisations (ALEO) where the ALEO may formally be separate from the local authority yet subject to its control and influence.

Audit committees and equivalent in the public sector

Audit committees may not always exist. Some organisations may have a sub-committee of the board who are responsible for audit tendering and evaluation, for example a scrutiny & performance committee or project committee. In this guide we use the term “audit committee” to include equivalent arrangements.

1.2 Why it is a good idea to evaluate and tender audit services

It is a statutory requirement for public and charitable bodies to ensure that their financial statements are audited¹ (unless eligible for smaller body exemptions). A regular evaluation of the auditor’s performance helps to ensure that you get the service needed. Whilst only organisations audited through national frameworks have a set timetable and there are no legislative requirements for other public bodies to tender their audit, there are some very good reasons why tendering should be considered:

- It is good business practice to periodically tender for the supply of many goods and services – this applies to audit as for other any other significant purchase. It is in the entity’s interest to be satisfied that the service they are paying for is fit for purpose and gives value.

¹ Public sector legislation varies depending on the sector and jurisdiction e.g. Local Government (Scotland) Act 1973, Charities Act (ICAS guidance charity audit exemption - England and Wales), Local Audit and Accountability Act 2014 (England) and bodies audited by the Auditor General (Public Finance and Accountability (Scotland) Act 2000 section 21) etc. Some audit exemptions exist for smaller bodies.

- If the audit service provider has not been rotated for a long time, the risk of over-familiarity and potential for conflicts of interests increases, which may affect audit quality and reduce effectiveness.
- A fresh approach and new perspective can provide new insights and observations.
- The experience of tendering audits has largely been positive with benefits outweighing costs.
- It is important to have a good quality audit so directors/senior management need to make sure that the organisation is getting what it should from its auditors. A tender may help.

A quality audit can benefit the organisation

- A good audit ensures you comply with legislation and are kept abreast of changes in accounting standards, tax regulations etc. which could impact your organisation.
- The auditor brings professional scepticism, critical appraisal and a questioning mind which can highlight issues in your organisation that are an opportunity or are an area of risk to be managed. They can also identify potential misstatement due to error or fraud.
- It provides independent, professional judgement:
 - affirming the effective operation of procedures and controls,
 - identifying control failures, and
 - providing independent assurance to stakeholders.
- Constructive challenge of management strengthens governance and reduces the opportunity for 'group think'.
- Auditors have cross-lateral experience from providing services to a varied client base which offers:
 - a professional and informed sounding board,
 - the ability to question existing practices (are they right, can they be improved?),
 - an external perspective on the business model and management attitudes, and
 - the opportunity to understand comparative practice.

In addition, following a sound and transparent tendering process supports compliance with the 7 Principles of Public Life (**The Nolan Principles**) which sets out the principles of behaviour and ethical standards expected of public office holders and which should underpin ethical decision making. There is also the **Councillors Code of Conduct** issued by the Standards Commission for Scotland.

Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.

UK government - the 7 principles of public life

Context

"Public audit is a combination of specific legal requirements, professional requirements, best practices as applied to public interest entities in the private sector and the requirements that are designed to ensure that public audit adds value for audited bodies, the public and their elected representatives."

Audit Scotland Code of Audit Practice 2016

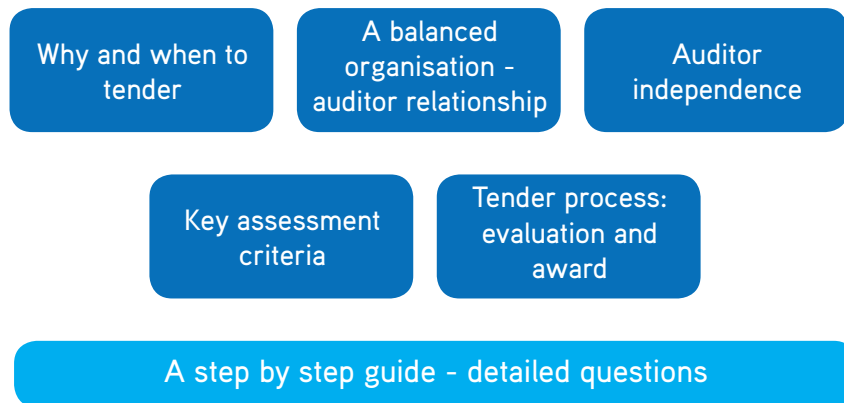
There are various mechanisms for appointing auditors across the UK public sector. Many public sector entities have their auditor appointed by a statutory body responsible for securing the audit². Others are subject to audit by a statutory body with some of the work sub-contracted to audit firms. Others are empowered to make their own audit appointment.

² For example, the Accounts Commission, National Audit Office, Northern Ireland Audit Office, Public Sector Audit Appointments, Wales Audit Office.

2. SUMMARY OF THE AUDIT TENDER PROCESS

A well-managed tender process avoids unnecessary time and costs.

The following aspects of a tender process are explained:



2.1 Why and when to tender?

It is good practice to ensure that the audit is fit for purpose and offering value. Regular evaluation of the auditor's performance and tendering are means to achieving this – see more on [why it is a good idea to tender audit services](#) in section 1.2.

Triggers for retendering may arise from the following:

- (a) **Approaching the final year of a fixed-term audit appointment.**
- (b) **Changes of key personnel** in the organisation or audit firm such as the Finance Director, Audit Committee Chair (or equivalent) or Audit Engagement Partner may trigger a need for an audit tender (for example, where it impacts on independence).
- (c) **An unsatisfactory review** of the incumbent auditor's performance.
- (d) **A very long relationship with the audit firm** that is starting to raise concerns about over-familiarity and independence.
- (e) **Concerns around the effectiveness of the audit** – the audit approach may need refreshing to reflect new developments such as the increasing use of data analytics.
- (f) Motivation to **test the market** to make sure the service being offered is the most appropriate for the organisation, or
- (g) A motivation to facilitate **a review of the value for money** of the current service offering, subject to audit quality not being compromised.

Frequency of tendering

Many public sector organisations are subject to regulatory requirements for tender frequency, with 5 years being a common appointment period. There is a balance to achieve the benefits of rotation yet avoiding a rotation period which is so frequent that it incurs unnecessary cost and reduces the efficiency of the audit, particularly in the first year where the auditor has to get to know the client.

There should be sufficient time for a professional client/auditor working relationship to be developed and optimised. The first year may involve a familiarisation period for both client and auditor - this investment is beneficial for both parties in subsequent years. As a comparative, under the EU Directive issued in 2016, listed companies and other public interest entities are required to tender every 10 years and change their auditors every 20 years.

For those bodies which are subject to fixed auditor rotation terms, the perceived benefits of regular rotation include:

- maintaining objectivity,
- avoiding complacency,
- promoting audit independence, and
- creating a more competitive market.

It is good practice to periodically reassess and challenge what is an appropriate frequency for tendering. Too long may impact on independence and too short may not be maximising efficiency and productivity.

Planning a tender

The tendering of an audit should be on the audit committee's forward agenda - appropriate planning is critical for the success of the process. For example, it helps to time a tender well ahead of the year-end to allow planning, handover and stock counts to be arranged. Typically, a good time is soon after the prior year audit is signed off.

Clear objectives of what the organisation or appointing body is looking to achieve from tendering should be established and included in the Proposal Request to firms.

Some public sector external audit engagements are covered by a national framework appointment. Audit providers on these frameworks will have already submitted pre-qualification information which have been accepted. This reduces the need to request such information again, so it is worth checking what information has already been provided.

The executive/senior management team should keep the audit committee members/equivalent informed about plans and timescales for audit rotation and tendering.

2.2 Organisation – Auditor Relationship

A good working relationship between the audit committee/equivalent, finance director, the finance team and the auditors can take time to develop and is generally a pre-requisite for a high-quality audit.

The ideal relationship between each can be represented as an equilateral triangle where there is balance without dominance and professional respect. This means that the relationship between the external auditors and the audit committee has to be as strong as the relationship between the external auditors and the finance director/finance team.



Maintaining oversight

Although a formal audit committee may not exist, it is advised that the board/sub-committee replicates some of its functions to maintain appropriate oversight of how effectively audit responsibilities are discharged including:

- (a) **Monitoring audit effectiveness, efficiency and the ongoing relationship between the auditors and the organisation:**
 - An annual assessment of the qualification, expertise, resources, and independence of the external auditors and the effectiveness of the audit process should form part of this process.
- (b) **Developing a policy on the provision of non-audit services.** If these are significant it can cause independence issues and so senior management/executive approval is usually needed for this. It should include any restrictions which may be contained in contracts with appointing bodies, the services which can be carried out by the auditor and the approval limits, such as:
 - Identification of any services specifically precluded by the contract terms of an appointing body,
 - A level for management to sign off (fairly low),
 - A level requiring audit committee chair sign off and if he/she believes appropriate, the views and approval of the full audit committee/equivalent can be sought.
- (c) **Awarding and monitoring non-audit services:**
 - The policy and auditor ethical standards for non-audit services should be complied with – see also section 2.3 Auditor Independence in this guide and the **FRC Ethical Standard**.

2.3 Auditor Independence

The interest of the user of the financial statements is paramount. Auditors have a duty to act objectively. Conflicts of interest can influence the auditor's judgement or actions and threaten objectivity which may reduce the effectiveness and the quality of the audit.

It is expected that the audit committee/equivalent takes an active role to ensure the independence, objectivity and effectiveness of auditors, and *be able to demonstrate that they have done so*.

Objectivity and independence of mind are crucial drivers of audit quality. Meeting audit independence requirements is an important criterion when it comes to deciding which firms should be invited to tender.

High quality independent audit is one of the cornerstones of public accountability. It gives assurance that taxpayers' money has been well managed and properly expended. It helps to inspire trust and confidence in the organisations and people responsible for managing public money.

Public Sector Audit Appointments - Audit Services Outline Procurement Strategy

Auditors can offer other services to share their knowledge and expertise with clients. Access to additional services can help some organisations address skills or knowledge gaps. This may also be a factor in auditor selection. However, there is a balance regarding the scale and type of non-audit services provided to avoid over reliance on auditors and the erosion of independence.

As part of the decision on which firms to invite to tender, the assessment of independence of firms must include those currently supplying non-audit services to the organisation. Key questions include:

- Do the firms satisfy the necessary independence requirements for the firm to tender, and
- How do you ensure that they stay independent during the tender period?

Audit committees/equivalent will also need to ensure any restrictions or regulatory limits on the scale of non-audit services are adhered to, for example, public sector audit appointments made by statutory bodies as part of a national framework arrangement³. Whilst smaller organisations, or those not part of a public sector audit framework, may not be subject to the same prohibitions, the principle of objectivity is relevant to all organisations.

³ Such as the Accounts Commission, National Audit Office, Northern Ireland Audit Office, Public Sector Audit Appointments, Wales Audit Office.

All audit firms should have processes in place as part of their own quality controls regarding the procurement of non-audit services, to ensure the objectivity, integrity and independence of the auditors is not threatened.

Audit firms also need to adhere to the Financial Reporting Council (FRC) **Ethical Standard** (2016) which contains the principal rules on auditor independence in the UK⁴.

Threats to independence could include:

- Familiarity (long tenure, auditor connections with the organisation/staff),
- The proportion of the fee for audit and/or non-audit services, and risk of financial dependence on the client,
- Auditor taking on management responsibility,
- Potential impact of non-audit service on the financial statements, and
- Any potential for self-review.

Some threats can be managed (where feasible) by applying appropriate safeguards. For further details see the **Ethical Standard 2016**.

A long tenure and connections with the organisation, whether financial or otherwise, may increase the risk of over-familiarity, conflicts of interest and diminish the auditor's ability to exercise independent judgement and challenge. This is inconsistent with the principle of independent audit.

Communicating the decision to tender the audit well in advance can facilitate a "cleansing" process to ensure that a range of firms can meet independence requirements by the time of the appointment.

Care is also required to ensure that when appointing a new member of the senior management team that the appointment does not impact (or be seen to impact) upon the independence of the auditors. This includes the perceived influence of audit firm alumni in the senior management team, or any relationship between the auditor and members of the audit committee/equivalent.

Some organisations set terms and conditions as part of the tender process. Care is needed to ensure that clauses do not deter bidders. An example could be to request the auditor to take on some form of management responsibility which would be inconsistent with their independence duties.

Independence - overarching principle

"...free from conditions and relationships which would make it probable that an objective, reasonable and informed third party would conclude the independence of the firm or any covered person is compromised."

Source: **FRC Ethical Standard 2016**

For local public audit, the NAO also publishes Auditor Guidance (**AGN01**) detailing requirements for provision of non-audit services. Audit Scotland includes a statement in their Annual Planning Guidance **2017-18**.

⁴ **FRC Ethical Standard 2016** Section 2 details the requirements on financial, business, employment and personal relationships. For some entities, the independence requirements will also include those of regulators based in other jurisdictions.

⁵ Covered person is defined as "—A person in a position to influence the conduct or outcome of the engagement" **FRC Glossary**

2.4 Key Assessment Criteria

Objectives for retendering + audit quality drivers = key assessment criteria.

To ensure the process is fair and competitive, tender documents should state the selection criteria for assessing proposals and access to information on the organisation should be equally available to all bidders.

A key objective of the audit is to provide stakeholders with confidence that the organisation's financial statements can be relied upon⁶. Audit quality has to be at the heart of the selection criteria.

Assessment is likely to consider 5 main areas as shown below.



a) Cost & value – quality first at a fair price

Cost does not always equate to value. The prime focus should always be on quality as it is critical that the organisation obtains the most appropriate auditor for its needs whilst also achieving best value and demonstrating appropriate stewardship of public funds.

Some shortlisting approaches use weightings against certain scoring criteria to meet organisational objectives. Placing undue emphasis on price is not recommended – this is likely to achieve a false economy by undermining the prime objective of audit procurement, being to source high quality audit services for a fair price. Too much downward pressure on fees can reduce the ability to operate effectively and ultimately reduces the choice of suppliers. Competition is one aspect of a healthy market.

Increasingly firms are comparing the commercial feasibility of engagements which include additional non-audit services they can provide to organisations without restriction, against audit appointments for defined periods when they are barred from providing non-audit services. This may result in firms applying a strategic approach when invited to submit an audit tender and may lead to them declining to tender.

At the heart of the assessment criteria must be “audit quality”. The overriding objective of undertaking an audit tender should be to seek to ensure that the organisation has the most appropriate auditor for its needs.

⁶ A formal definition is provided by the FRC “The auditor’s objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes the auditor’s opinion.”
Description of the auditor’s responsibilities for the audit of the financial statements

b) Audit quality

Key assessment criteria may include the following:

(i) Audit quality - the effectiveness of the audit process

The firms should be asked to explain the audit approach that they will adopt and illustrate how they believe this best meets the needs of the organisation.

Sectoral understanding

The scope of a public sector audit is wider than simply to provide stakeholders with confidence that the organisation's financial statements can be relied upon.

The wide scope of public audit, covering the audit of financial statements, regularity, propriety and value for money. Public audit involves more than an opinion on accounts. It also covers issues such as regularity, propriety and value for money. In this way, it helps to contribute to corporate governance arrangements of public bodies and public trust in entities delivering public services.

Public Audit Forum - our principles

The proposed audit approach should demonstrate understanding of the organisation, its sector, any key specialisms, major risks and how the auditor will respond to those risks. There is a balance however. Focusing on solely identical sector experience can mean missing out on good practice and insights from other sectors. Ultimately this can also create entry barriers to the audit market and reduce competition.

The assessment needs to ensure that the firm and those staff to be involved on the audit have the appropriate knowledge and experience of the sector in which the organisation operates to be able to undertake a quality audit. For example, a firm may be asked to provide information on relevant sector experience over the last 3 years and to provide details of what they see as the main risks and issues likely to be faced by the sector in the next 5 years and how that would impact on auditor responsibilities.

Experience of organisations with similar levels of complexity, not solely identical experience can be beneficial. Cross-sector experience has value and too tightly defined a requirement may reduce potential suppliers and therefore competition.

Capacity to undertake the work

Firms operating in the sector should be able to identify key partners, managers and field staff who possess the requisite skill sets to provide a quality service in the sector. They should be requested to identify a proposed team with the required sector skills and the ability to deliver the audit service in a timely manner.

Firms should have an appropriate training programme in place to ensure their staff meet all continuing professional development requirements and are aware of current issues facing the sector.

Geographic coverage and the firm's network/ability to resource this should be considered if group entities exist or the entity operates across various locations.

Firms should be invited to explain their approach and experience of working with other firms where there is, or there is the potential for, collaborative working between bodies in service delivery going forward.

The auditor's response to the identified risks would be expected to include:

- An assessment of materiality,
- How specific high-risk areas would be audited,
- The approach and scope of audits of other undertakings within the group, and
- The audit approach to systems, controls and IT processes.

Other questions for auditors may include:

- **An explanation of their approach to innovation** and the extent to which technology will be integrated into the audit approach (including, where relevant, data analytics),
- **Use of scenarios to allow the auditors to illustrate their professional judgement** - this might involve asking the prospective candidates to comment on the organisation's accounting policies. Care is required to avoid opinion shopping – the objective is to illustrate sound judgement and understanding, not to identify the lowest regulatory bar.

Comparing input measures such as audit hours as a driver of cost may not always be appropriate. The key question is audit quality and how this is achieved. Effective use of data analytics and technology are developments which some firms use that may reduce staff hours but increase efficient audit coverage and analysis.

(iii) The firm's audit quality record

Firms are required to adhere to professional standards and guidance issued by professional bodies. While audit firms will be subject to external quality reviews by quality monitoring bodies they should also have internal quality assurance procedures in place. Firms should be able to provide details of both external and internal quality reviews and the actions put in place to address issues arising from the reviews.

The firm's audit quality control arrangements should be assessed and audit quality review reports reviewed (where available). The reports for larger firms are published by the FRC. Smaller firms are subject to monitoring/quality review by their professional body⁷. Their reports are not published but it can be helpful to discuss review findings with the lead partner.

The initial request for information from firms can include an explanation of how they ensure they comply with independence requirements as well as their approach to ensuring an appropriate ethical culture exists within the firm⁸.

Audit firm and engagement lead compliance with regulatory standards

Audit is a regulated activity and there are restrictions on who can conduct an audit. Every firm conducting audit work must be registered with, and subject to supervision by, a Recognised Supervisory Body (RSB) of which ICAS is one (for others see the **Register of Statutory Auditors**).

Individuals responsible for signing audit opinions within each firm must hold a recognised qualification and the firm must apply for them to be approved by the firm's RSB as a Responsible Individual (RI) via a rigorous vetting process. This includes detailed assessment of qualifications, audit experience and continuing professional development requirements. RI status is not portable and is linked to the firm. If the person moves firm, their RI status ceases and must be reapplied for in the new firm.

⁷ The monitoring of audit firms with public interest entity (PIE) clients is conducted by the FRC's internal Audit Quality Review team.

In the case of a small firm with 10 or less PIEs, the monitoring is conducted by the Recognised Supervisory Body (RSB), being an approved professional accountancy body. For ICAS see **audit monitoring**.

⁸ Some audit firms are required to publish annual Audit Firm Transparency reports which can provide some initial information on culture. However, this only applies to auditors of UK companies with securities admitted to trading on a UK regulated market. It highlights how the firms seek to ensure audit quality and compliance with the requirements of the UK Audit Firm Corporate Governance Code.

For auditors of Local Public Audits i.e. audits of local public bodies in England⁹, arrangements are different. Statutory guidance on the level and experience of individuals who can sign off an audit opinion on behalf of the firm for specified English public bodies is set by the Local Audit & Accountability Act 2014 and FRC regulations, as explained in the **FRC website**.

The firm must apply to be a Local Audit firm with a Local Audit RSB (ICAS is one). This licence is different from the general audit licence mentioned above. The firm must also apply to that RSB to authorise each person intending to sign Local Audit audit opinions as a Key Audit Partner (KAP). Both applications require a detailed assessment by the RSB. The KAP status is not portable and is linked to the firm.

c) Access to additional services - the firm's skills and experience and best fit with organisational needs

The entity may need to access additional specialists, expertise and non-audit services. A firm's capability to supply these to meet knowledge/skills gaps in the organisation may be an additional factor.

The firm's wider experience and understanding of key specialisms, systems, relevant cross-lateral experience, experience/ability to operate in certain jurisdictions and technical knowledge may strengthen the firm's ability to provide useful insights and add value.

d) Organisation auditor relationship

Factors include the skills and personal qualities of audit partners and staff such as:

- Personal chemistry with the audit lead and ability to form a constructive working relationship,
- Mutual respect and the auditor's ability to challenge, exercise professional scepticism and maintain integrity,
- The engagement lead and audit team demonstrate appropriate knowledge and experience,
- Effectiveness of communication and chemistry, and
- The lead partner's audit quality and performance record (internal personal appraisals and references may be available).

Asking firms in person to explain briefly what their values are and their approach to business ethics can help to indicate likely fit.

e) Effective communication

Public auditors publish their results as part of the accountability process to the public, elected representatives and other key stakeholders, including funders. It is essential that reporting arrangements are effective.

Firms should explain their approach to communicating with management and the audit committee. Senior management should assess the planned frequency of written and verbal communication so deadlines can be met and to ensure clarity of communication on technical issues.

Additional sources for assessing audit quality

- **FRC- Audit Quality – Practice Aid for Audit Committees**
- **Public Audit Forum - Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom** provides guidance on the application of quality control and auditing standards issued by the Financial Reporting Council (FRC) to the audit of public sector bodies in the United Kingdom.

⁹ These are principally local authorities and health bodies, other than Foundation Trusts.

2.5 The Tender Process

This section outlines practical tips and what to expect at each stage of the process.

Thorough planning and careful execution helps minimise the time and costs for both management or the appointing agency, and the audit firms.

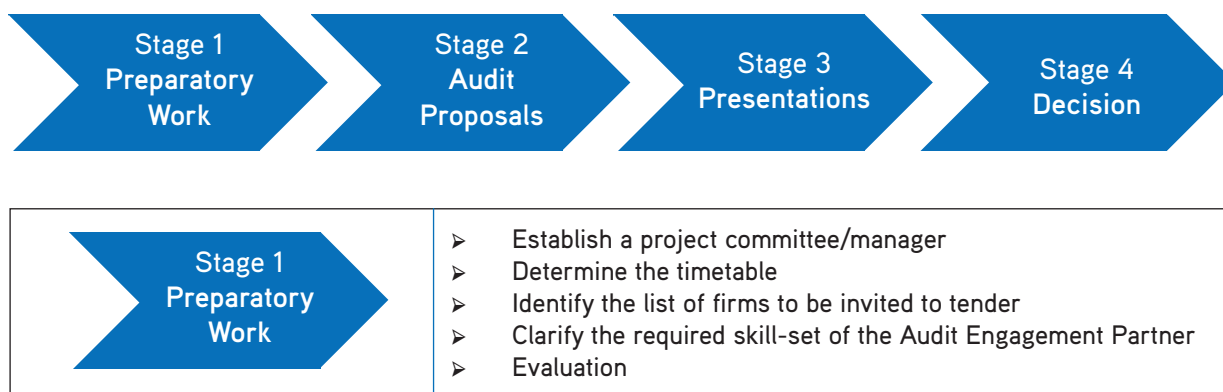
Where the audit appointment is made directly by the public sector body, overall responsibility, control and decision-making on the tender process lies solely with the audit committee/equivalent. All members of the audit committee need to be engaged on this issue, not just the chair.

The aim should be to conduct the tender at the time it will have least impact or disruption on the organisation.

It is good practice to evidence the audit committee's/equivalent rationale for selecting their choice of audit firms.

What to expect at each stage of the process

Good practice tendering usually follows four stages.



Establish a project committee

The audit committee (or equivalent) is responsible for controlling the process but it is good practice to identify a project manager to ensure the project progresses as planned. Some activities may be delegated. Entity staff or external consultants may be engaged to support the audit committee with the process, but responsibility remains with the committee. Smaller organisations are likely to take a less formal approach.

Determine the timetable

The timetable should confirm:

- Key project planning dates,
- What information will be made available to candidates and how,
- What access will they have to management, and
- What access may they have to the incumbent auditor.

It is important to set the dates early. The Proposal Request (PR) should set out:

- The dates when the data room will be open (where it exists),
- When the management meetings will take place,
- When the tender will take place and closing date, and
- Availability of key contacts and audit committee members in the organisation.

Identify the list of firms to be invited to tender

The body should try to tap into the knowledge of their organisation's network. They may have knowledge of other audit firms through other services they provide to the organisation or through professional networks.

Potential conflicts should be considered before identifying the tender list, such as the potential impact on audit independence of a firm currently providing non-audit services to the entity and whether they should be excluded from the invitation to tender. While the individuals providing audit and non-audit services may be different, a firm's prior provision of non-audit services may lead to an actual or perceived loss of independence were the auditor required to comment objectively on the work of colleagues.

In preparation for the tender process the project manager can produce a questionnaire to help gather information from the firms directly.

A review of the firm's independence should be carried out at this stage (**see section 2.3 Auditor Independence**).

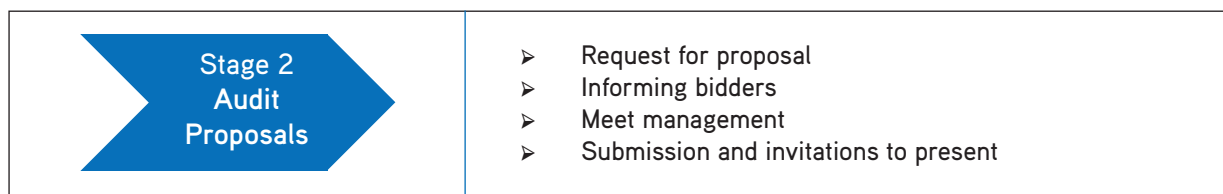
Required relevant skill-set – Audit Engagement Partner/Responsible Individual

The level of skills and experience required of the audit engagement partner or responsible individual (RI) will need clarified¹⁰. This allows a discussion of the respective firms' capabilities and any independence issues etc. Knowledge of the individual from previous experience of audit rotation, or through professional networks can inform this.

For smaller entities the RI might be a director. It is worth considering evaluation of the team members as they are likely to be the key people the organisation's staff will work with most often.

Evaluation

Audit committees need to decide on a means of fairly evaluating and ranking the prospective candidates against objectives. Some use a scorecard; management views should be included before voting on the final decision.



Proposal Request (PR)

All potential bidders should be treated fairly to ensure a fair competitive process. The PR should seek to ensure a level playing field and the same pack of background information should be available to all the prospective firms.

The main aspects of the tender process should be included in the PR:

- the timetable and key dates e.g. submissions deadline,
- key contact details,
- expected deliverables from the firms, and
- the assessment criteria and weighting.

Communicating assessment criteria better informs prospective firms to help them formulate their audit approach and submit an informed tender. The format of the PR and tenders should be 'clear and concise'. Many request firms to limit the length of their tender documents (to around 20 pages) and limit the number of appendices.

¹⁰ The FRC has published statutory **Guidance for Local Public Audit** to ensure that the RSBs' rules, to ensure that Key Audit Partners have the necessary skills and experience

Informing bidders

Firms will need access to detailed information about the organisation to help them identify what they believe to be the key business and audit risks (this may not directly apply if the organisation is part of a national audit framework). This may be through providing relevant documents for inspection at specific times or by creating access to secure online data. One method is the “data room” which is increasingly common however this is less likely for smaller organisation audits. Data rooms require controlled access and a main contact person for questions.

The availability and access to information should be the same for all firms tendering.

Information to be shared with bidders

This is a decision for the audit committee/equivalent, but the information would normally include the following (not exhaustive – see the checklist in section 3 for more detail):

- Details of the entity i.e. group structure including geographic locations, business type and organisation charts, business/strategic plan and current/future budgets.
- Accounting information including statutory accounts, group reporting requirements and systems to help indicate the scale of audit work.
- Relevant audit committee and board papers.
- The most recent management letter and any other report issued by the auditor to the organisation or those charged with governance.

Care is required not to overwhelm participants with too much information which could hamper knowledge building.


Meet management

The firms should be given the opportunity to meet with key personnel to allow them to gain a more comprehensive understanding of the entity and its business model, risks and internal controls. It also helps to strengthen the quality of submissions and tailor the service on offer. Meetings with local management at key sites may be required.

To help manage the process efficiently, consideration should be given to informing the firms that access is limited to specific dates and locations to minimise ad hoc requests.

Submission and invitations to present

Following receipt and review of submissions, all, or a shortlist of preferred firms can be invited to present (stage 3). This is an opportunity for those with a credible chance of winning the bid, it is not appropriate to invite extra candidates to make up numbers as there are costs on both sides.

	<ul style="list-style-type: none">➤ Format and focus of presentations of service offerings➤ Selecting attendees from the audit firms➤ Fees – quality first at a fair price
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Format and focus of presentations of service offerings

Formats vary from a formal presentation to going through the submissions already received to a question and answer session. Audit committees should be clear upfront what is expected. **Where an audit appointment is made directly by the organisation** the entire audit committee/equivalent should attend the presentations, usually with some members of the management team, e.g. the Finance Director and the Financial Controller. Board members/equivalent can be invited.

Where the audit appointment is made by an appointing body, those involved should have experience of the audit process in the sector to ensure that relevant questions are put to the firms.

The focus of these sessions should be on how the firms would:

- intend to conduct the audit,
- work in partnership with other auditors where there is an overlap of responsibilities,
- deal with difficult judgemental issues, and
- communicate with management, the audit committee and any external body to whom reports are submitted.

Larger organisations may decide to set the audit firms a technical challenge. These can be considerably varied but tend to focus on matters relating to an accounting or auditing issue and/or ethics and independence issues. The firms could also be asked to provide their views on the organisation's accounting policies and possibly other key matters stated in their most recent financial statements. Opinion shopping must be avoided – whilst it may be useful to hear different views, it is not a case of choosing the auditor with the lowest regulatory bar.

Those involved in the interview process should be briefed on findings and conclusions of inspection/monitoring reports to support their assessment of the bidders. For larger audit firms this would include the audit firms' Transparency Reports and the FRC Audit Quality Review inspection report.

Selecting attendees from the audit firms


Depending on the organisation's circumstances and needs, the involvement of specialists may help to inform an assessment. For example, audit partners responsible for IT, other specialists and more junior members of the team might provide a broader view, although too many people can become cumbersome. Decisions can be influenced by the perception of the quality of staff supporting the RI so the audit manager and in some cases audit in-charges can be useful attendees.

Fees - quality first at a fair price

The audit committee/equivalent should be responsible for audit fee negotiations. Some organisations analyse the fee quotes and brief the audit committee on the issues arising before the presentations are made. They can then challenge the firms as to delivery of audit quality (if there is a low quote) or ask them to justify a higher than expected fee (for example: what additional assurance arises from the higher fee, do they believe the prior auditors did not deliver the quality audit that they will deliver etc.).

Some organisations are shortlisting the preferred firm before considering the fee. This helps focus the decision to appoint based on quality and expertise rather than price. Some use separate envelopes for the bid and fee. In this approach the fee is negotiated after the decision is made on which firm to appoint.

Audit quality must be the overriding factor in the decision-making process. The key factor is to choose an auditor who meets the tender objectives, quality standard and organisation's needs.

	<ul style="list-style-type: none">➤ References➤ Recommendation and approval➤ Announcement➤ Feedback to bidders➤ Engagement letter
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References

References for the audit firms can be identified and should be taken up for the firm it is planned to award the audit to.

Recommendation and approval

For audit appointments made by the body itself, it should reconfirm internally and with the proposed auditor that there are no conflicts which have not been identified or disclosed earlier in the tender process. Once the audit committee/equivalent has made its decision, a recommendation and supporting rationale should be given to the board.

Where appointments are made by appointing organisations, the organisation should contact the body to be audited who will need to check and confirm that no conflicts exist before appointment.

Announcement

The audit appointment is then announced/published. Note: there may be additional/different requirements across different sectors.

Feedback to bidders

It is helpful if feedback is provided to the bidding firms on their performance during the tender process with reasons why the successful firm was chosen and/or why they were not chosen.

Engagement letter

The auditor should provide an engagement letter which confirms the scope and responsibilities of the auditor and client to ensure that a full understanding exists on both sides. This should be reviewed, signed and returned to the auditor.

3. A STEP BY STEP GUIDE – DETAILED QUESTIONS ON AUDIT TENDERING

These guidance questions offer a step by step approach to tender planning and evaluation. It should be adapted to the organisation's individual circumstances.

Planning		
1.	Has the audit committee formulated a policy for how often it would intend to put the organisation's external audit out to tender and if so, has that policy been agreed at board level?	
2.	Have all relevant jurisdictional requirements been identified which may impact the organisation's tender process e.g. use of national frameworks, EU tendering requirements or operations in other countries in which the organisation has a presence?	
3.	Have the reasons for putting the audit out to tender been clearly debated and objectives established?	
4.	Has the most appropriate time in the year to undertake the tender process been confirmed?.	
Tender Process Stage 1 – Preparatory Work		
<i>Objective setting and project management</i>		
5	Have the key assessment criteria (scorecard) been established on which the ultimate decision will be based? <i>This should also be used to score each firm's written submission and presentation and will include a list of necessary skills and services (subject to independence requirements) required of the auditors.</i>	
6.	Has a project committee been established to oversee the tender process?	
7.	Has an appropriate individual been given responsibility for leading the tender process?	
8.	Has a timetable been prepared for the process, including providing adequate access for the firms to senior management, finance personnel and the audit committee? Is the timetable feasible given the likely demands on the time of senior personnel?	
<i>Identifying potential firms</i>		
9.	Has consideration been given to seeking views from other appropriate parties, independent of the executive/ senior management team, on which possible firms to include in the process?	
10.	Do you already use any of the firms selected to provide non-audit services? <i>Their performance may provide an indication as to the suitability of the firm concerned.</i>	
11.	Has an analysis been performed to ascertain which audit firms it would be appropriate to invite to participate in the tender process? Does this analysis include:	
	a) Reputations of audit firms (including whether the subject of investigation and outcome)?	
	b) Industry knowledge and expertise?	
	c) Any past experience of audit firms?	
	d) Financial stability, risk profile and litigation record?	
	e) Any personal references?	
	f) Nature and reach of auditor's network?	
	g) Review of available audit providers' information if provided on public sector audit frameworks?	

<i>Independence and conflict checking</i>		
12.	Have the executive/senior management team identified any independence issues that they may have with any of the firms being considered?	
13.	Do any other potential conflicts exist, such as existing relationships, engagements with the organisation or regulatory or professional requirements, which could exclude a particular audit firm from the tender process?	
	If any such conflicts currently exist, will these still be an issue at the date the audit appointment is due to commence?	
	Has the organisation started to manage the work being awarded to those firms invited to tender so as not to create potential independence issues?	
<i>Skills and experience – assessing capability</i>		
14.	Do the audit firms identified have the necessary expertise of the sector(s) in which your organisation or group operates?	
15.	Does the organisation's audit or other assurance requirements necessitate specialist skills (e.g. actuarial skills) and does each of the identified potential candidates possess these skills?	
16.	Have preliminary meetings been held with prospective firms to seek to get an understanding as to whether that firm has the capability to conduct the audit?	
Tender Process – Stage 2 – Audit Proposals		
17.	Has the audit committee prepared a Proposal Request (PR) document which will allow all parties to tender on an equal footing? <i>The scope of the work being tendered needs to be clearly defined in the tender document. It should clearly set out the details of the tender process including the evaluation criteria to be used, the key contact at the entity and relevant dates.</i>	
18.	Has the required content of the written proposals to be submitted by the firms and the maximum length been specified?	
19.	Does the PR explain the process by which those tendering can access information about the organisation including:	
	a) A schematic of the group's structure, geographical locations and legal status of entities?	
	b) Financial performance?	
	c) Control framework?	
	d) IT infrastructure and strategy?	
	e) Internal audit structure, role and responsibilities?	
	f) Risk management processes?	
	g) Organisation structure charts?	
	h) Prior year accounts and other corporate information, as appropriate?	
	i) Accounting procedures manuals?	
	j) An overview of the financial accounting business systems, software, whether unified or disparate systems across the organisation/group, how managed, if monthly/quarterly reporting, etc?	
	k) Reporting procedures manuals?	
	l) Other relevant information (such as audit committee and board papers)? (Access to this information can be via an online secure data room.)	

20.	Have the relevant audit firms provided a statement of independence and have they got policies in place to ensure they remain independent until the tender process is completed?	
21.	Where time and cost constraints permit, have plans been made for the shortlisted firms to visit selected typical organisation or group operations?	
22.	Is there a process to enable the audit committee to receive feedback on shortlisted firms from other relevant managers in the organisation, where appropriate?	
Tender Process – Stage 3 – Tender presentations		
23.	Has a list of questions been prepared for the final presentations?	
24.	Has it been decided which personnel from the shortlisted audit firms should be invited to attend?	
25.	Consider, who from the organisation other than audit committee members should be invited to attend the face to face presentations - and have dates been reserved for them (the Finance Director and Financial Controller would normally be in attendance)?	
26.	Has it been ensured that the firms' submissions and presentations will be assessed based on the key assessment criteria?	
27.	Are the people presenting to the audit committee those that will conduct the audit?	
28.	Have the following factors (in no particular order) been considered in making the final decision on the appointment of the auditors:	
	a) Reputation and financial stability of the firms?	
	b) Audit approach?	
	c) Views of stakeholders, regulators and financiers, as appropriate?	
	d) Previous experience and recommendations from others?	
	e) Value for money?	
	f) Reputation, personality, perceived quality, experience, enthusiasm, demonstrable interest in the organisation, of the key audit partners and staff?	
	g) Depth of audit team expertise and technical back-up, including access to any necessary specialists?	
	h) Business understanding?	
	i) Industry expertise?	
	j) Geographic service capability?	
	k) Independence and objectivity?	
	l) Procedure for ensuring continuing independence and objectivity?	
	m) The extent technology will be integrated into the audit approach?	
29.	Has the audit committee properly documented its conclusions?	
30.	Have plans been made to announce the decision?	

Points to note

If the decision is made following a tender process to change the current auditor and appoint new auditors, then there will be various legal and procedural matters which will need to be addressed. This may involve seeking external legal advice. This should be undertaken once a decision has been made but prior to any public announcement.

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