

Town of Fort Myers Beach
Agenda Item Summary

Blue Sheet Number: 2010-139

1. Requested Motion:

Meeting Date: Nov 1, 2010

The Town Council moves to create an audit committee and seek applications for the committee from the public.

Why the action is necessary:

What the action accomplishes:

2. Agenda:

☐ Consent
☒ Administrative

3. Requirement/Purpose:

☐ Resolution
☐ Ordinance
☒ Other

4. Submitter of Information:

☐ Council
☐ Town Staff
☐ Town Attorney

5. Background:

On September 23, 2010, the Town Attorney has provided to the Council a memo regarding the statutory requirements for selection of an auditor to conduct the Town's annual financial audit (attached).

6. Alternative Action:

The Town Council designates itself as the audit review committee.

7. Management Recommendations:

Staff recommends appointments from the public.

8. Recommended Approval:

Town Manager	Town Attorney	Finance Director	Public Works Director	Community Development Director	Cultural Resources Director	Town Clerk
						

9. Council Action:

☐ Approved ☐ Denied ☐ Deferred ☐ Other

Memorandum

TO: Mayor and Town Council

FROM: Marilyn W. Miller

DATE: September 23, 2010

RE: Auditor Selection Procedures

The following is being provided to inform you of the statutory requirements for selection of an auditor to conduct the Town's annual financial audit. Those requirements are contained in Section 218.391, Florida Statutes.

Section 218.391(2), Florida Statutes provides that the governing body of a municipality shall establish an audit committee and that the primary purpose of the audit committee is to assist the governing body in selecting an auditor to conduct the annual financial audit required in Section 218.39, Florida Statutes. Once established, the audit committee may, but is not required, to serve other audit oversight purposes as determined by the governing body.

Section 218.391(3), Florida Statutes, mandates that the audit committee establish factors to be used for the evaluation of audit services, including ability of personnel, experience and ability to furnish the required services. Once those factors are established, the audit committee publicly announces a request for proposals (RFP) and provides interested firms with the RFP. The audit committee then evaluates the proposals that have been provided by qualified firms and ranks and recommends, in order of preference, no fewer than three firms deemed to be the most highly qualified to perform the required audit services. The Town Council then selects one of the firms recommended by the audit committee and proceeds to negotiate a contract. If compensation was not one of the factors used by the audit committee to evaluate the firms, then the Town Council shall attempt to negotiate a contract with the firm that was ranked first. If compensation was one of the factors used by the audit committee to evaluate and rank the firms, then the Town Council must select the highest-ranked qualified firm or must document in the public records the reason for not selecting the highest-ranked qualified firm. A third alternative method provides that the Town Council may select one of the firms recommended by the audit committee and may use an appropriate alternative negotiation method for which compensation is not the sole or predominant factor used to select the firm.

To assist local governments in establishing an audit committee and in selecting an auditor for perform the annual financial audit, the State of Florida, in 2007, established an Auditor Selection Task Force whose members represented various associations such as the Florida Government Finance Officers Association, the Florida League of Cities, Florida Institute of Certified Public Accountants and the Auditor General's Office. That task force has promulgated a document entitled "Auditor Selection Guidelines" that contains statutory requirements and

non-mandatory guidance in the various aspects of the selection process. A copy of that document is attached for your convenient reference.

The first step for the Town Council is to establish the Audit Committee. Most local governments establish the committee by resolution. The resolution typically describes membership eligibility requirements; the committee's duties, and rules for the conduct of their meetings.

If you have any questions concerning the foregoing, please do not hesitate to contact me.

Attachment

cc: Town Manager Terry Stewart

Auditor Selection Guidelines

2007

Prepared by the Auditor Selection Task Force

Acknowledgements

The primary contributors to these guidelines were the members of the Auditor Selection Task Force as follows:

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A special thank you goes to Stephen Gauthier, Director of the Technical Services Center of the Government Finance Officers Association, who provided updated information related to the GFOA publications related to auditor selection.

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Auditor Selection Law

Section 218.391, Florida Statutes, establishes required procedures for the selection of auditors to perform the annual financial audits required by Section 218.39, Florida Statutes. This section of law was amended by Chapter 2005-32, Laws of Florida, effective July 1, 2005, to specify a consistent auditor selection process for all counties, municipalities, special districts, district school boards, charter schools, and charter career technical centers. Section 218.391, Florida Statutes, as amended, is included as Appendix A to these guidelines.

Chapter 2005-32, Laws of Florida, implemented recommendations made by the Auditor Selection Task Force established by the Auditor General for the purpose of providing recommendations to the Legislature for improvements in the auditor selection requirements. A basic premise of the Task Force Report, as stated in the report, was that the use of an adequate auditor procurement process helps ensure selection of a qualified auditor and satisfactory audit effort (i.e., audit effort sufficient to detect significant noncompliance, control deficiencies, or a lack of reasonable and necessary business practices).

The Task Force included representatives of the Florida Institute of Certified Public Accountants, Florida Government Finance Officers Association, Florida Association of Counties, Florida Association of Court Clerks and Controller, Florida League of Cities, Florida Association of Special Districts, Florida School Finance Officers Association, and Florida Association of Public Purchasing Officers. Also included were a staff member of the Legislative Auditing Committee and individuals representing charter schools and citizens.

The auditor selection law, as amended by Chapter 2005-32, Laws of Florida, establishes an auditor selection process that requires the use of an audit committee, a request for proposal (RFP) for the solicitation of the necessary audit services, and a selection and negotiation process in which fees cannot be the sole or predominant reason for selecting a particular audit firm. The Task Force recommendations, as well as the resulting legislation, were based on the concept of establishing minimal mandatory legal requirements, with additional non-mandatory detailed guidance to be promulgated by the Auditor General or professional associations in the following areas:

- Use of audit committees
- Composition of audit committees
- Use and elements of an RFP for audit services
- Use and elements of audit services contracts

The purpose of this document, which was prepared by the Task Force, is to provide additional non-mandatory guidance in the selection of auditors for performing the annual financial audit required by Section 218.39, Florida Statutes. Additional auditor selection topics are addressed in Appendix B to these guidelines, Questions and Answers. Appendix C provides a listing of resources used to prepare the guidelines.

Audit Committee Composition and Size

Legal Requirements

Section 218.391, Florida Statutes, requires that the governing body of each charter county, municipality, special district, district school board, charter school, and charter technical career center establish an audit committee. The composition of the audit committee is not specified, except that the composition for a noncharter county, at a minimum, must include each of the county officers elected pursuant to s. 1(d), Art. VIII, of the State Constitution, or a designee, and one member of the board of county commissioners or its designee.

Non-mandatory Guidance

While, as indicated above, the composition of an audit committee is not specified in the law (other than the required members for noncharter counties), the effectiveness of an audit committee in performing its assigned duties is certainly dependent on the qualifications and skills of its members and the relationship of the members to the governing body.

In its *Recommended Practice –Audit Committees (1997, 2002, and 2006)*, the GFOA made the following recommendations on the composition of audit committees:

- *Ideally, all members of the committee should possess or obtain a basic understanding of governmental financial reporting and auditing. The audit committee also should have access to the services of at least one financial expert, either a committee member or an outside party engaged by the committee for this purpose. Such a financial expert should through both education and experience, and in a manner specifically relevant to the government sector, possess 1) an understanding of generally accepted accounting principles and financial statements; 2) experience in preparing or auditing financial statements of comparable entities; 3) experience in applying such principles in connection with the accounting for estimates, accruals, and reserves; 4) experience with internal accounting controls; and 5) an understanding of audit committee functions.*

The *AICPA Toolkit* suggests that at least one member of the audit committee should have financial experience and provides guidance as to attributes that comprise financial experience, including an understanding of relevant accounting principles and auditing standards; experience in preparing, auditing, analyzing, or evaluating financial statements; an understanding of internal controls and procedures for financial reporting; an understanding of audit committee functions; and a general understanding of the government environment. The AICPA also suggests some alternative approaches to acquiring financial experience on the audit committee, including obtaining assistance from other government organizations or audit committees; engaging an independent financial professional; or providing a training program for audit committee members.

- *All members of the audit committee should be members of the governing body. To ensure the committee's independence and effectiveness, no governing body member who exercises managerial responsibilities that fall within the scope of the audit should serve as a member of the audit committee.*

This recommended practice suggests that the actual audit committee membership be composed of the governing board or a subset of the governing board. Under this approach, it is likely that the entity will need to engage an outside party to obtain the needed experience in governmental financial reporting and auditing. Additionally, the audit committee could be provided an orientation on the duties and responsibilities of the committee, including such topics as objectives of internal control, accounting, auditing and financial reporting to assist in making sound judgments.

- *An audit committee should have sufficient members for meaningful discussion and deliberation, but not so many as to impede its efficient operation. As a general rule, the minimum membership of the committee should be no fewer than three.*

Another factor that could affect the size of the audit committee, particularly in small communities, is the availability of individuals who possess both the skills desired of an audit committee member and the willingness to make the commitment to perform effectively as a member. It is important that the entity not compromise these factors, as well as independence considerations, in establishing the size of the audit committee.

- *Members of the audit committee should be educated regarding both the role of the audit committee and their personal responsibility as members, including their duty to exercise an appropriate degree of professional skepticism.*

This recommended practice suggests that training with regard to the audit committee function should be provided to the committee members. This is particularly critical where the committee members are governing board members who may not possess the needed experience in governmental financial reporting and auditing. At a minimum, such training might include making members familiar with these guidelines and the publications referenced herein.

Small Government Considerations

Smaller entities may experience difficulty in obtaining the necessary experience in governmental financial reporting and auditing from a source that is independent from financial management of the entity. Qualified persons willing to provide such experience may simply not be available within the community. In such instances, the small entity might consider consulting with larger entities in the area to identify employees or consultants of those entities who might be willing to work with their audit committee. Should the small entity opt to not establish an audit committee composed of governing board members, the small entity could seek to use the audit committee of the larger entity as their audit committee. While it would not be appropriate to simply engage an audit firm because it was

selected by another entity, the other entity's audit committee could conduct the auditor selection process on behalf of the small entity. Regardless of the method used to provide an audit committee function, ultimate responsibility for the selection of the auditor rests with the governing body.

Audit Committee Responsibilities

Legal Requirements

The primary purpose of the audit committee, as contemplated in Section 218.391, Florida Statutes, is to assist in the selection of an auditor to conduct the annual financial audit required by Section 218.39, Florida Statutes; however, Section 218.391(2), Florida Statutes, provides that the audit committee may serve other audit oversight purposes as determined by the entity's governing body. Additionally, the law provides that the public may not be excluded from the audit committee's proceedings.

Section 218.391(3), Florida Statutes, establishes the duties of the audit committee to include:

- Establishment of factors to be used for the evaluation of audit services to be provided by the audit firm.
- Public announcement of an RFP.
- Provision of interested firms with the RFP.
- Evaluation of proposals provided by qualified firms.
- Ranking and recommendation in order of preference of no fewer than three firms deemed to be the most highly qualified to perform the required services. If fewer than three firms respond to the RFP, the committee shall recommend such firms as it deems to be the most highly qualified.

Non-mandatory Guidance

Establishment of the Audit Committee. Prior to the enactment of Chapter 2005-32, Laws of Florida, entities subject to the annual audit requirement were required to establish auditor selection committees. As described above, Chapter 2005-32, Laws of Florida, expanded the previous auditor selection committee to an audit committee that may be used for purposes other than auditor selection, as determined by the governing body.

The Government Finance Officers Association (GFOA) Recommended Practice, *Audit Committees (1997, 2002, and 2006)*, describes the audit committee as "... a practical means for a governing body to provide much needed independent review and oversight of the government's financial reporting processes, internal controls, and independent auditors." The GFOA's concept of an audit committee clearly encompasses functions beyond the selection of the auditor in stating "An audit committee also provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. By effectively carrying out its functions and responsibilities, an audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in effect to objectively assess management's practices, and that the independent auditors, through their own review, objectively assess the government's financial reporting practices."

The GFOA recommended procedure advises that the audit committee be formally established by charter, enabling resolution, or other appropriate means. In addition to addressing the composition of the audit committee (see the previous section, Audit Committee Composition and Size), the formal means can be used to establish the responsibilities of the audit

committee and avoid subsequent confusion or conflict over the authority of the audit committee.

Should the audit committee be assigned responsibilities suggested by the GFOA that are in addition to the statutorily prescribed auditor selection function, the GFOA recommends that the audit committee be made directly responsible for the appointment, compensation, retention, and oversight of the work of any independent accountants engaged for the purpose of preparing or issuing an independent audit report or performing other independent audit, review, or attest services. GFOA further recommends that, under such circumstances, the audit committee be established in such a manner that all accountants thus engaged report directly to the audit committee. If the audit committee is assigned oversight responsibilities with respect to the independent audit and the establishment of internal controls and adequate management processes, the GFOA Recommended Practice, *Audit Committees (1997, 2002, and 2006)* should be consulted for additional guidance.

Audit Committee Responsibilities. The American Institute of Certified Public Accountants (AICPA) has recently established an Audit Committee Effectiveness Center (www.aicpa.org/audcommctr/homepage.htm) that addresses many of the responsibilities that might be performed by an audit committee and presents “the guidance and tools to make audit committee best practices actionable.” The Center includes, among other resources, an *AICPA Audit Committee Toolkit: Government Organizations* that is available on the web site or by purchase in book form from the AICPA. The Toolkit provides guidance in establishing and staffing an audit committee, as well as accomplishing the objectives of the audit committee. An “Audit Committee Charter Matrix,” included in the *AICPA Toolkit*, suggests steps to be taken to accomplish the objectives, deliverables to be provided, and frequency or due dates for the various steps. The *AICPA Toolkit* also includes guidelines for conducting an audit committee self-evaluation.

The *GFOA Handbook* indicates that the scope of the audit committee’s responsibilities should be established by formal action of the governing body and the audit committee should be directly responsible for all aspects of audit management. The GFOA publication, *Governmental Accounting, Auditing, and Financial Reporting (GFOA Blue Book)*, states: The audit committee’s primary responsibility should be to oversee the financial reporting and disclosure process, including all aspects of the independent audit, from the selection of the auditor to the resolution of audit findings. The audit committee should have access to the reports of any internal auditors, as well as access to any annual internal audit work plans. The audit committee should present to the governing board and management an annual written report of how the committee has discharged its duties and met its responsibilities.” With respect to auditor selection, the *GFOA Handbook* states that the audit committee should perform the following functions in addition to those required by law:

- Plan the procurement process
- Determine the appropriate scope of the audit
- Prepare the RFP

Planning the procurement process would involve planning and coordinating the auditor solicitation process including performance of the specific functions indicated in Section 218.391(3), Florida Statutes.

As previously indicated, Section 218.391, Florida Statutes, requires the establishment of an audit committee by each entity required to procure an annual financial audit pursuant to Section 218.39, Florida Statutes. The law authorizes, but does not require, use of the audit committee for other purposes. Audit committee responsibilities recommended by the *GFOA Handbook*, which are in addition to the statutorily prescribed auditor selection responsibility, include:

- Monitoring the audit

The *GFOA Handbook* indicates that concerns of interest to the audit committee during the audit would include whether the audit is progressing on schedule and whether potential problems are identified and immediately corrected, if appropriate. Potential problems might include difficulties in gathering information or contacting key personnel, discovery of instances or indications of irregularities or illegal acts that require immediate attention, and circumstances that could result in less than an unqualified opinion. Monitoring can be accomplished through periodic progress reports or meetings.

- Review of the financial statements prior to completion of the audit

The *GFOA Handbook* recommends that this review place special emphasis on changes that have occurred since the issuance of the previous period's financial statements and on amounts in the financial statements that involve the use of estimates or judgment.

- Review of the results of the audit

The *GFOA Handbook* recommends that the audit committee review each of the auditor's reports to gain a thorough understanding of problems identified by the auditor and provide the background needed to address resolution of the problems. In view of the emphasis placed on management letters in Florida law and the Rules of the Auditor General, the audit committee review should encompass the management letters required to be submitted as a part of the audit report. For the audit committee to effectively review the results of the audit, the results must be communicated in a manner that assures a thorough understanding by the audit committee members. In lieu of relying solely on the delivery of a written audit report, this might be accomplished at a meeting in which audit committee members have an opportunity to ask questions of the auditors. This could be done either in addition to, or in conjunction with, a public meeting of the entity's governing board at which governing board members would also have an opportunity to question the auditors. If the findings are presented at a governing board meeting, consideration should be given to a meeting convened solely or predominantly for this purpose to assure that the findings are adequately communicated.

- Evaluating management's proposed corrective action plans

Specified entities are required by Auditor General Rule 10.558(1) to provide the Auditor General with responses to all audit findings included in their annual financial audits. The responses are required to include corrective action to be taken to resolve each finding.

- Monitoring corrective action taken

The *GFOA Handbook* points out that while it is management's responsibility to implement corrective action related to audit findings, the audit committee should be responsible for monitoring management's implementation. The *GFOA Handbook* suggests that governing bodies may wish to consider requiring management to answer to the governing body for any failure to implement corrective action plans in a timely manner and to the satisfaction of the audit committee. In monitoring implementation of corrective actions, the Audit Committee should consider and evaluate any management disagreement with auditor recommendations or concerns as to the costliness of implementation.

- Evaluating auditor performance

The *GFOA Handbook* views auditor evaluation as the first step of the subsequent year's audit procurement or, if audit procurement is not scheduled for the subsequent year, a process for identifying and recommending needed improvements in the auditor's performance. The *GFOA Handbook* recommends that the audit committee meet with management to discuss matters pertaining to the auditor's performance including: ability to meet deadlines; compliance with other provisions of the audit contract; competence and cooperativeness of the audit staff; and thoroughness and reasonableness of audit adjustments, findings, and recommendations. The *AICPA Toolkit* includes a questionnaire that can be used to evaluate the independent auditor. The questionnaire includes questions for audit committee members, key government executives, and the independent auditor.

In performing these responsibilities, the Audit Committee may determine a need for audit procedures that are in addition to the minimum procedures necessary to issue an opinion on financial statements. Such information would be useful in preparing future requests for proposals.

Communications with the Audit Committee. To the extent that the audit committee has responsibilities beyond the auditor selection responsibility, effective communication between the auditors and the audit committee is necessary. The AICPA establishes generally accepted auditing standards to which auditors of entities in Florida are subject, together with *Government Auditing Standards* promulgated by the Comptroller General of the United States. Generally accepted auditing standards require that auditors communicate certain matters with persons having responsibility for oversight of the financial reporting process and define the recipient of such communications as the audit committee (AU para. 380.01,

AICPA Codification of Statements on Auditing Standards). Matters required to be communicated to the audit committee include:

- the auditor's responsibility under generally accepted auditing standards
- significant accounting policies and implementation
- management judgments and accounting estimates
- audit adjustments that could, either individually or collectively, have a significant effect on the entity's financial statements
- judgments about the quality of the government's accounting principles
- other information included with financial statements
- disagreements with management
- consultation with other accountants
- major issues discussed with management prior to retention of the audit firm
- difficulties encountered in performing the audit

Additionally, generally accepted auditing standards require that the auditor communicate with the audit committee regarding internal control-related matters (AU Section 325, AICPA Codification of Statements on Auditing Standards) and illegal acts (AU Section 317, AICPA Codification of Statements on Auditing Standards).

Government Auditing Standards (para. 4.07) provide that information such as potential restrictions of the auditor's reports, such as inclusion of any material that is classified for security purposes or not releasable to particular parties or the public for other valid reasons, be communicated and that written communication is preferred. The auditor's communication of information to the audit committee will assist the audit committee in reviewing the financial statements and monitoring the audit.

The *AICPA Toolkit* describes, and provides an example of, an Issues Report from Management, that can be used to document any significant issues, judgments, and estimates that may have a material impact on the financial statements, for discussion with the audit committee. The *AICPA Toolkit* also provides further guidance and examples regarding the types of information the auditors are required to communicate to the audit committee.

Small Government Considerations

While smaller entities may lack the resources to expand the use of the audit committee to accommodate all or many of the non-mandatory functions described above, all entities, regardless of size, are required to use the committee for auditor selection. The entities are encouraged to use the audit committees for the other functions to the extent available in their particular circumstances. Additional discussion regarding the establishment of audit committees by small governments is included in the Audit Committee Composition and Size section.

Audit Proposal Evaluation Factors

Legal Requirements

Section 218.391(3)(a), Florida Statutes, requires that the audit committee establish the factors to be used for the evaluation of audit services to be provided and that such factors include, but not be limited to, ability of personnel, experience, ability to furnish the requested services, and such other factors as may be determined by the committee to be applicable to the particular requirements. Section 218.391(3)(d), Florida Statutes, prohibits the use of compensation as the sole or predominant factor for evaluating proposals.

Non-mandatory Guidance

Consistent with Florida law, the *GFOA Recommended Practice – Audit Procurement (1996 and 2002)* states: “The audit procurement process should be structured so that the principal factor in the selection of an independent auditor is the auditor’s ability to perform a quality audit. In no case should price be allowed to serve as the sole criterion for selection of an independent auditor.”

Audit Firm Qualifications. While Florida law prescribes minimal audit firm qualifications that must be considered, the *GFOA Handbook* describes an evaluation process that includes both criteria that must be met in order to qualify for a more detailed review and a method for rating the technical qualifications of proposers. The criteria listed by the GFOA include:

- Meeting applicable independence criteria.
- License to practice as a CPA in the state.
- Receipt of adequate continuing professional education by key personnel.
- Completion of a quality control review within the past three years.
- A history of performing quality audits.

The *GFOA Handbook* considers these to be criteria, the absence of which cannot be compensated by other credentials.

Technical Qualifications. The *GFOA Handbook* establishes two categories for technical qualifications of proposers: (1) expertise (ability) and experience, and (2) audit approach. Ability and experience qualifications include:

- Past experience and performance on comparable government engagements.
- Quality of the professional personnel to be assigned to the engagement and quality of the firm’s management support personnel to be available for technical consultation.
- Experience with specific state and Federal grant programs.
- Information technology ability

Audit approach qualifications include:

- Approach to documentation and review of the comprehensive framework of internal control.
- Adequacy of proposed staffing plan (hours and level) for the various segments of the engagement.
- Adequacy of sampling techniques.
- Adequacy of analytical procedures.

The *GFOA Handbook* points out that technical qualifications should be tailored to meet each government's unique environment and specific audit requirements and cites as an example a government that sponsors its own pension plan for employees, which might require actuarial expertise.

The *GFOA Handbook* recommends assignments of ranges of point values to each criterion to aid in the evaluation of the technical qualifications of proposers. The use of ranges of point values allows the entity to reflect the relative importance of the qualifications for that government and engagement and allows the evaluator the flexibility to reflect qualitative differences in the qualifications presented in the proposals.

Use and Elements of Request for Proposal

Legal Requirements

As indicated previously, Section 218.391(3)(c), Florida Statutes, requires that the audit committee provide interested audit firms with an RFP. The RFP is required to include information on how proposals are to be evaluated and such other information as the committee determines is necessary for the firm to prepare a proposal.

Non-mandatory Guidance

The *GFOA Blue Book* describes the purpose of the RFP as follows: “A sound RFP should obtain from proposers all information needed to evaluate their technical qualifications to perform the audit. The RFP also should provide proposers with a detailed description of the government, its specific audit needs, and the government’s audit procurement process.”

Public Announcement for Audit Services. As previously indicated, Section 218.391(3), Florida Statutes, provides that the audit committee’s duties shall include public announcement of an RFP and provision of interested firms with the RFP. To achieve the benefits of a competitive selection process, it is critical that there be sufficient responses by qualified audit firms to the RFP to assure an opportunity for competition. The *GFOA Handbook* states that a well-planned solicitation effort is needed to identify a sufficient number of qualified audit firms. This can be accomplished in a variety of ways and the law does not mandate any specific method. The method selected should provide sufficient time for the potential responders to prepare an appropriate response. The *GFOA Handbook* identifies several methods of identifying qualified audit firms, including advertisement in local newspapers, notice in a publication of the state society of certified public accountants, inquiries of other entities in the same region, and direct mailing to audit firms. In Florida, all local government audit reports are required to be filed with the Auditor General who maintains a database of audit reports received, including the names of the audit firms that conducted the audits. To promote competition, the method of noticing the RFP should be designed to reach as many potential providers of audit services as possible. For example, if the entity opts to advertise in a newspaper, the newspaper selected should have adequate coverage to assure an opportunity for a sufficient number of responses.

Elements of the Request for Proposal. The *GFOA Handbook* includes a list of 24 information elements that should be considered in designing an RFP for audit services. These elements generally either provide information to the prospective proposers regarding the RFP evaluation process or assure that adequate information is provided by the proposers to allow for an informed decision by the entity. The RFP might not include all of these elements, but they should be considered and those elements considered to be appropriate for the given circumstances should be incorporated into the RFP. The elements listed in the *GFOA Handbook*, supplemented by additional guidance found in the *AICPA Toolkit*, consist of:

1. *How proposals will be evaluated.*

The RFP should clearly state the factors upon which the selection will be based and could provide:

- a. The relative weights of the evaluation factors, particularly with respect to qualifications and price, when price is considered as one of the evaluation factors.
- b. A statement that price will not be the sole or predominant factor to assure that highly qualified firms will receive appropriate consideration and to discourage the submission of proposals with unrealistically low prices by less qualified firms.
- c. Auditor qualifications that are mandatory for all proposers.
- d. Particular qualifications that will be considered most favorably (e.g., experience with particular grant programs).

2. *Procedures to be followed in the proposal process.*

The prospective proposers who will be incurring the cost of preparing and presenting a proposal will need specific information as to how to respond to the RFP. Such information might include:

- a. The appropriate format to use in making the proposal.
- b. Identification of a contact person.
- c. Whether there will be a proposal conference or on-site inspections.
- d. Information regarding the submission of prices.
- e. Other aspects of the proposal process, including submission deadlines, consideration of late proposals, and notification of results.

3. *Brief description of the government and its accounting systems and financial reporting structures.*

Prospective proposers require information that will provide a basis for determining the type and amount of resources that will be needed to perform the audit. This information might include:

- a. General description of the government.
- b. Organizational chart and key personnel.
- c. Size of the government (e.g., geographic area, number of employees, total budget or payroll).
- d. Reference to documented policies and procedures.
- e. Fund structure and basis of accounting.
- f. Involvement in Federal and state assistance programs.
- g. Description of pension plans.
- h. Information regarding component units and joint ventures.
- i. Magnitude of financial operations.

- j. Scope of electronic data processing operations including types of computers in use (e.g., mainframes and personal computers), networking, software vendors, and major applications).
- k. Existence, size, and scope of the internal audit function.
- l. Contact person for access to prior audit information.

The *AICPA Toolkit* also includes guidelines for describing the government organization, which include, in addition to the items listed above:

- a. Year of incorporation
- b. Charter date
- c. Form of government
- d. Term length and term limits for elected officials
- e. Composition of governing body
- f. Composition of audit committee
- g. Activities and services provided by the government to its citizenry
- h. Component units and joint ventures

4. *Known weaknesses in the government's internal control structure*

Prospective proposers will want to be made aware of significant known internal control deficiencies. This could be accomplished by providing the proposers with a copy of the prior year audit report (including financial statements, auditor's reports, and management letters), prior year adjusting entries, and evidence of corrective actions.

5. *Anticipated implementation problems arising from new authoritative pronouncements.*

The classic example of a new authoritative pronouncement that could impact the RFP response was the implementation of GASB Statement 34. While all entities should have implemented GASB Statement 34 by now, an entity's readiness to implement other new pronouncements, as well as new laws or regulations having a significant impact on the entity's financial operations and reporting could impact the auditor's consideration of the resources needed to perform the audit.

6. *Principal contacts inside and outside the government.*

Examples of contacts that proposers might want to be aware of as individuals with whom they will be expected to interact during the engagement include:

- a. Chief executive officer
- b. Chief financial officer
- c. Audit committee members
- d. Director of internal audit
- e. Grants management personnel
- f. Legal counsel

7. *Level of assurance to be required of the auditor for each type of information contained within the report.*

The auditor will need to be made aware of circumstances that might impact the scope of the audit. Such circumstances might include the audit of the financial statements of a component unit by another audit firm, and specific legal requirements that will require a statement in the auditor's management letter regarding compliance.

8. *Auditing standards required for the engagement.*

Pursuant to Florida law and the Rules of the Auditor General, all required annual financial audits of entities in Florida are to be performed in accordance with *Government Auditing Standards* promulgated by the Comptroller General of the United States. The RFP might include a statement to this effect to avoid any misunderstanding.

9. *The auditor's specific reporting responsibilities.*

Although the auditor's reporting responsibilities are described in the auditing standards and the Rules of the Auditor General, the *GFOA Handbook* recommends listing the reporting responsibilities in the RFP. This could be most easily accomplished by reference to the Rules of the Auditor General, Chapter 10.550 (*Local Governmental Entity Audits*), Chapter 10.800 (*Audits of District School Boards*), or Chapter 10.850 (*Audits of Charter Schools and Similar Entities*), as appropriate.

The *AICPA Toolkit* includes guidance for addressing the scope of the work to be performed by the auditor, including:

- a. A general description of the services being solicited
- b. Expected deliverables, such as:
 - 1) Expression of opinion in conjunction with a full-scope audit of a comprehensive annual financial report (CAFR) (optional under Florida law and Rules of the Auditor General) or a report on basic financial statements only (minimum requirement for all local government audits)
 - 2) Federal or state single audit reports (required if certain thresholds are met)
 - 3) Management letter (required for all local government audits)

Expected deliverables should also include any requirement for separate opinions for any debt issues or to meet any other reporting requirements.

10. *The type and amount of assistance available from the government.*

Entities can sometimes reduce the cost of their audits by providing certain assistance to the auditor. To formulate the type and amount of resources to be applied to the audit, the auditor needs information as to the type and extent of assistance that will be available from the entity. The *GFOA Handbook* refers to various types of assistance including internal audit, clerical, and electronic data

processing. A statement might be included acknowledging that the government is responsible for preparing draft financial statements. Any anticipated concerns regarding the ability of the government to do so should be disclosed.

11. *Required audit timetable and deliverables.*

The *GFOA Handbook* recommends that the RFP include the latest acceptable dates for the following, assuming that information needed to meet these dates, is provided to the auditor on a timely basis:

- a. Entrance conference.
- b. Completion of interim audit work.
- c. Completion of year-end field work.
- d. Submission of audit adjustments and draft findings.
- e. Exit conference.
- f. Issuance of reports.

12. *Additional services to be required of the auditor.*

Auditors have often provided additional services beyond audit services in the past; however, the ability of auditors to provide nonaudit services to an audit client has been severely limited by *Government Auditing Standards*. Careful consideration should be given to the restrictions on such services prior to including them in the RFP. The *GFOA Blue Book* includes a discussion on the types of consulting (or nonaudit) services that may be performed by independent auditors, referring to the two overarching principles provided in *Government Auditing Standards*:

- Auditors should not perform management functions or make management decisions
- Auditors should not audit their own work or provide non-audit services in situations where the amounts or services involved are significant/material to the subject matter of the audit

The *GFOA Blue Book* provides examples of specific services that the independent auditor firm may or may not provide.

13. *Information on auditor workspace and access to telephones, copiers, FAX machines, and computers.*

As a practical matter, the *GFOA Handbook* suggests that information on the location and type of workspace that will be made available to the auditor, as well as availability of telephones, internet access, copy machines, FAX machines, and computer hardware, might be included in the RFP.

14. *Procedures to be followed to determine if additional audit work is necessary and the fee basis applicable to such work.*

Circumstances sometimes arise in which the scope of the audit may need to be expanded beyond what was anticipated in the RFP. For example, an entity might request the auditor to perform additional work in an area where certain control weaknesses have been discovered by the auditor. For any scope expansion anticipated in the RFP, the auditor should be provided with sufficient information to allow the determination of a proposed fee. The *GFOA Handbook* recommends that the RFP include a provision that the scope of the audit may only be broadened with the consent of the government and a request that proposers indicate how the fee for additional work related to a scope expansion would be determined.

15. *Information needed from proposers to evaluate their qualifications.*

A primary purpose of the RFP is to provide the government with information needed to assess the professional skill and experience of the auditors who will perform the engagement. The *GFOA Handbook* recommends that the RFP ask for the following information regarding the proposer:

- a. Overall size of the audit firm.
- b. Location and number of professional staff who will perform the engagement.
- c. Identification and qualifications of personnel to be assigned to the engagement, including:
 - i. Names and government audit experience of the partner in charge of the audit and other partners who will be assigned review or quality control functions.
 - ii. Names and government audit experience of the manager and other supervisory personnel.
 - iii. Information on certification, licensure, and CPE training of each of the above.
 - iv. Information on membership in professional societies (e.g., AICPA, FICPA, FGFOA, GFOA, AGA) of each of the above.
 - v. Background and qualifications of all other professional audit or other staff assigned to the engagement.

The *GFOA Handbook* also recommends that the RFP clearly set forth: (1) the circumstances in which the audit staff may be changed; (2) the need for new staff to meet the same level of qualifications; and (3) the government's right to reject or approve replacements.

16. *Requirement for auditors to furnish a statement that they meet the appropriate criteria for independence.*

Auditors are required to maintain independence, both in fact and appearance, with regard to audit clients. The *GFOA Handbook* suggests that the RFP require a

formal statement from the proposers that they meet all appropriate guidelines for independence

17. *Request for references from other government clients.*

The *GFOA Handbook* suggests that the RFP include a request for references asking proposers to furnish the names of similar governments for which they have recently performed similar audits, together with contact information.

18. *Request for information on the results of peer reviews.*

Government Auditing Standards require that auditors performing audits in accordance with those standards (this includes all required annual financial audits for entities in Florida) undergo external quality control, or peer, reviews of their policies and procedures every three years. The *GFOA Handbook* recommends that the RFP ask auditors to state whether their most recent peer reviews included a review of the quality of specific *government* audits. The RFP should also ask for the results of desk or field reviews of their audits by Federal or state grantor agencies.

19. *Request for information on the status of any disciplinary actions undertaken against the firm.*

The *GFOA Handbook* recommends that the RFP request information on whether any disciplinary action has been taken against the firm at the Federal or state level and, if such action has been undertaken, the current status of the action. Under Florida law (Section 455.225, Florida Statutes), complaints against certified public accountants are subject to a probable cause determination prior to a disciplinary action.

20. *Request for detailed information on the proposer's anticipated audit approach.*

The *GFOA Handbook* points out that, in addition to information regarding the qualifications of the proposer, the proposer's audit approach should be evaluated to determine that the proposer has a sound understanding of the scope of the engagement and the government's environment. Additionally, the government needs assurance that the proposer will apply the appropriate level of effort needed to perform the engagement satisfactorily. The *GFOA Handbook* recommends that the RFP ask for the following types of information:

- a. The extent to which the firm proposes to employ statistical sampling techniques.
- b. The extent to which the firm proposes to employ analytical procedures.
- c. The manner in which the firm intends to segment the engagement.
- d. The hours of staff time at each level that will be devoted to each segment.
- e. The approach proposed for gaining and documenting the auditor's understanding of the government's internal controls.
- f. The approach proposed for determining which laws and regulations should be tested for compliance.
- g. The method of drawing samples for tests of compliance.

21. *Requirements applicable to working papers and cooperation with other auditors.*

The *GFOA Handbook* recommends that the RFP establish clearly the period for retention of the auditors working papers by the auditor and the parties who are allowed access to the working papers. In establishing the retention period, the government should consider that the working paper retention period established by the Florida Department of State for all independent audits of local governments is three years. This should be considered a minimum retention period in drafting an audit services contract. As to accessibility, the *GFOA Handbook* recommends that the RFP include provisions providing accessibility to: Federal cognizant agencies; principal auditors, where component units are audited by other auditors; parties designated by the government as part of an audit quality control review; and successor auditors for matters relating to continuing accounting significance.

22. *Policy toward joint proposals or the use of subcontracting.*

The use of subcontracting or joint ventures on the part of auditors can be a means for encouraging participation by smaller firms. The *GFOA Handbook* recommends that any subcontracting after the audit contract is awarded be subject to the government's right to approve or reject subcontracting firms. Further, if joint proposals or subcontracting is allowed, the RFP should request proposers to identify the firm that will serve as the principal auditor, unless a special consortium is formed to conduct the engagement.

23. *Right to reject proposals, demand additional information, and use unsuccessful proposals.*

The *GFOA Handbook* recommends that the RFP indicate that:

- a. The government retains the right to reject any or all proposals.
- b. The government retains the right to request additional information from proposers and failure to provide the information could result in rejection of a proposal.
- c. The government reserves the right to retain proposals and use ideas from them.
- d. The government is not obligated in any manner to reimburse firms for costs incurred in connection with responding to the RFP.

24. *Any additional language to meet the requirements of applicable laws and regulations.*

The *GFOA Handbook* suggests that the government be aware of and include any specific language required by law or regulation.

The entity should exercise its judgment to determine which elements best fit its circumstances and should be included in the RFP.

Use and Elements of Audit Services Contract

Legal Requirements

Section 218.391(7), Florida Statutes, requires that every procurement of audit services be evidenced by a written contract embodying all provisions and conditions of the procurement of such services. An engagement letter signed and executed by both parties constitutes a written contract. The written contract shall include, at a minimum, the following:

- A provision specifying the services to be provided and fees or other compensation for such services.
- A provision requiring that invoices for fees and other compensation be submitted in sufficient detail to demonstrate compliance with the terms of the contract.
- A provision specifying the contract period, including renewals, and conditions under which the contract may be terminated or renewed. Section 218.391(8), Florida Statutes, provides that written contracts may be renewed without the use of auditor selection procedures and that such renewals shall be in writing.

Non-mandatory Guidance

The audit services contract is a legally binding agreement that should be prepared and reviewed with the advice of legal counsel. In its publication, *How to Avoid a Substandard Audit: Suggestions for Procuring an Audit*, the National Intergovernmental Audit Forum (NIAF) recommends that the RFP be incorporated into the contract by reference.

Engagement Letter. While Section 218.391(7), Florida Statutes, authorizes the use of an engagement letter as an audit services contract, if it is signed by both parties, the use of an engagement letter does not relieve the need to include all provisions that would constitute a good contract and protect both the government and the auditor.

Required Contract Elements. As indicated above, there are certain legally required elements that must be included in the audit services contract. Additional guidance for each of these elements follows:

- *Services to be provided and fees or other compensation (Section 218.391(7)(a), Florida Statutes).* The Practitioners Publishing Company (PPC) Guide to Audits of Local Governments advises that the contract clearly describe the nature of the services to be performed, including whether such services include Single Audits (Federal and/or State). The PPC also recommends that the contract clearly identify the financial statements to be audited and the period covered. Statement on Auditing Standards No. 74 recommends that the contract include a statement about specific audit requirements. Florida law and the Rules of the Auditor General include several such requirements in addition to the auditor's reports on the financial statements and State and Federal programs. Specifically addressing these requirements in the contract helps to preclude any subsequent misunderstandings regarding the auditor's responsibilities.

- *Invoices for fees and other compensation in sufficient detail to demonstrate compliance with the contract (Section 218.391(7)(b), Florida Statutes).* The PPC recommends that the basis for determining fees and the method of payment be included in the contract. The basis for payment may vary from a lump sum arrangement to specific rates to be paid for the services of specific employees or categories of employees of the audit firm and reimbursement for specific costs, such as travel, incurred in connection with the engagement. The level of detail on the invoice sufficient to demonstrate compliance with the terms of the contract will vary according to the basis for payment. In the case of a fixed fee contract, the basis for payment should be clearly defined within the audit services contract. If the contract identifies certain employees for which the firm will be paid at specified hourly rates, the contract should require invoices that indicate the numbers of hours worked by each employee and application of the appropriate rates. If the contract provides for reimbursement for certain actual costs, the contract should require invoices that demonstrate the amounts actually incurred by the firm in the form of receipts or similar documentation.
- *Contract period, renewals, and termination (Section 218.391(7)(c), Florida Statutes).* The contract must specify the number of years for which it will be in effect, including any options for renewal on the part of the government. The law does not prescribe a maximum term for an audit services contract or a maximum number of renewal periods. Once the contract period, including renewals, has expired, any further required annual audit services must be subjected to the auditor selection law as required by Section 218.391, Florida Statutes.

The GFOA, in its 2002 *Recommended Practice - Audit Procurement*, recommends that governmental entities enter into multiyear agreements of at least five years in duration when obtaining the services of an independent auditor. The GFOA points out that such agreements allow for greater continuity and help to minimize the potential for disruption in connection with the independent audit. The GFOA recommended practice further states that multiyear agreements can also help to reduce audit costs by allowing auditors to recover certain “start-up” costs over several years, rather than a single year. The appropriate length for the audit services contract is left to the judgment of the government.

Additional Contract Elements. Additional elements recommended by the NIAF for inclusion in an audit services contract, include:

1. Audit scope, objective, and purpose.
2. Deadlines for work to be performed.
3. Audit cost.
4. Report format.
5. Type and timing of support to be provided to the auditor by the government.
6. Professional auditing standards to be followed in performing the audit.
7. Independent contractor status of the auditor with respect to the government.
8. Changes made by written notice by the government within the general scope of the agreement, together with equitable adjustments to the cost of the audit using rates specified in the agreement.

9. Prior notification to the entity by the auditor, within a specified time and prior to beginning the related work, regarding changes in, or additions to, the scope of the engagement.
10. Auditor ownership of working papers prepared by the auditor during the audit, a designated retention period for the working papers, and availability of the working papers to the entity and governmental auditors upon request. The *GFOA Handbook* suggests, by way of examples, that access to the working papers during the retention period might include personnel of the audited government, Federal cognizant agency, State coordinating agency, Government Accountability Office, quality control reviewers, other governments providing assistance to the audited government, and successor auditors).
11. Ownership, use and control of all reports rendered to the government by the auditor, according to applicable laws and regulations.

Additional elements that are recommended by the *GFOA Handbook* to be made a part of the audit services contract include:

1. An independence assertion by the auditor.
2. Language describing the actions to be taken in the event of a disagreement as to whether certain procedures are within the scope of the agreement.
3. Legal provisions to assure the availability of the auditor's services to aid the government in the defense of claims that may arise as the result of audit work.
4. Legal language concerning opportunities for socially and economically disadvantaged individuals. Such language may be required by law or regulation.
5. Clarification of the auditor's duty to maintain the confidentiality of certain sensitive information.
6. Provisions establishing the government's rights to terminate the contract and the procedures for doing so.
7. Stipulation as to how the value of the auditor's work is to be determined if the engagement is terminated prior to completion.
8. Language establishing the auditor's sole liability for claims arising from the auditor's performance of the engagement.
9. Language requiring both the government and the auditor to resolve disputes amicably.
10. Requirement for formal notification to the other party to the agreement (e.g., a disagreement over the scope of the audit) and language indicating what is to be considered notification in such instance (e.g., registered mail).
11. Language specifying how the terms of the contract can be waived or modified.
12. Language to clarify that the contract's separate provisions are to stand alone, so that a failure to meet one provision does not nullify the entire contract.
13. A requirement for the auditor to obtain insurance coverage.
14. A prohibition against the auditor's delegating or subcontracting audit work without the government's permission.

As can be seen, different professional organizations have placed varying emphasis on the contents of the contract for audit services. Government management must determine the most appropriate provisions for a contract in a given set of circumstances and the specific elements and language to be included will ultimately be a matter of agreement between the entity and the audit firm.

APPENDIX A

Auditor Selection Law

218.391 Auditor selection procedures.--

(1) Each local governmental entity, district school board, charter school, or charter technical career center, prior to entering into a written contract pursuant to subsection (7), except as provided in subsection (8), shall use auditor selection procedures when selecting an auditor to conduct the annual financial audit required in s. 218.39.

(2) The governing body of a charter county, municipality, special district, district school board, charter school, or charter technical career center shall establish an audit committee. Each noncharter county shall establish an audit committee that, at a minimum, shall consist of each of the county officers elected pursuant to s. 1(d), Art. VIII of the State Constitution, or a designee, and one member of the board of county commissioners or its designee. The primary purpose of the audit committee is to assist the governing body in selecting an auditor to conduct the annual financial audit required in s. 218.39; however, the audit committee may serve other audit oversight purposes as determined by the entity's governing body. The public shall not be excluded from the proceedings under this section.

(3) The audit committee shall:

(a) Establish factors to use for the evaluation of audit services to be provided by a certified public accounting firm duly licensed under chapter 473 and qualified to conduct audits in accordance with government auditing standards as adopted by the Florida Board of Accountancy. Such factors shall include, but are not limited to, ability of personnel, experience, ability to furnish the required services, and such other factors as may be determined by the committee to be applicable to its particular requirements.

(b) Publicly announce requests for proposals. Public announcements must include, at a minimum, a brief description of the audit and indicate how interested firms can apply for consideration.

(c) Provide interested firms with a request for proposal. The request for proposal shall include information on how proposals are to be evaluated and such other information the committee determines is necessary for the firm to prepare a proposal.

(d) Evaluate proposals provided by qualified firms. If compensation is one of the factors established pursuant to paragraph (a), it shall not be the sole or predominant factor used to evaluate proposals.

(e) Rank and recommend in order of preference no fewer than three firms deemed to be the most highly qualified to perform the required services after considering the factors established pursuant to paragraph (a). If fewer than three firms respond to the request for proposal, the committee shall recommend such firms as it deems to be the most highly qualified.

(4) The governing body shall inquire of qualified firms as to the basis of compensation, select one of the firms recommended by the audit committee, and negotiate a contract, using one of the following methods:

(a) If compensation is not one of the factors established pursuant to paragraph (3)(a) and not used to evaluate firms pursuant to paragraph (3)(e), the governing body shall negotiate a contract with the firm ranked first. If the governing body is unable to negotiate a satisfactory contract with that firm, negotiations with that firm shall be formally terminated, and the governing body shall then undertake negotiations with the second-ranked firm. Failing accord with the second-ranked firm, negotiations shall then be terminated with that firm and undertaken with the third-ranked firm. Negotiations with the other ranked firms shall be undertaken in the same manner. The governing body, in negotiating with firms, may reopen formal negotiations with any one of the three top-ranked firms, but it may not negotiate with more than one firm at a time.

(b) If compensation is one of the factors established pursuant to paragraph (3)(a) and used in the evaluation of proposals pursuant to paragraph (3)(d), the governing body shall select the highest-ranked qualified firm or must document in its public records the reason for not selecting the highest-ranked qualified firm.

(c) The governing body may select a firm recommended by the audit committee and negotiate a contract with one of the recommended firms using an appropriate alternative negotiation method for which compensation is not the sole or predominant factor used to select the firm.

(d) In negotiations with firms under this section, the governing body may allow a designee to conduct negotiations on its behalf.

(5) The method used by the governing body to select a firm recommended by the audit committee and negotiate a contract with such firm must ensure that the agreed-upon compensation is reasonable to satisfy the requirements of s. 218.39 and the needs of the governing body.

(6) If the governing body is unable to negotiate a satisfactory contract with any of the recommended firms, the committee shall recommend additional firms, and negotiations shall continue in accordance with this section until an agreement is reached.

(7) Every procurement of audit services shall be evidenced by a written contract embodying all provisions and conditions of the procurement of such services. For purposes of this section, an engagement letter signed and executed by both parties shall constitute a written contract. The written contract shall, at a minimum, include the following:

(a) A provision specifying the services to be provided and fees or other compensation for such services.

(b) A provision requiring that invoices for fees or other compensation be submitted in sufficient detail to demonstrate compliance with the terms of the contract.

(c) A provision specifying the contract period, including renewals, and conditions under which the contract may be terminated or renewed.

(8) Written contracts entered into pursuant to subsection (7) may be renewed. Such renewals may be done without the use of the auditor selection procedures provided in this section. Renewal of a contract shall be in writing.

History---s. 65, ch. 2001-266; s. 1, ch. 2005-32.

Appendix B

Questions and Answers

1. **Question:** Are the auditor selection requirements of Section 218.391, Florida Statutes, to be applied whenever an entity contracts with a CPA firm for any audit or other services?

Answer: No. Section 218.391, Florida Statutes, applies only to contracting for the annual financial audit required by Section 218.39, Florida Statutes. However, the use of selection procedures such as those provided for in Section 218.391, Florida Statutes, and other Federal, State, or local laws is generally advisable when contracting for any services, audit or otherwise.

2. **Question:** Is there a legal requirement or recommendation for mandatory rotation of auditors after a specified number of years or at the end of an audit services contract?

Answer: No. Unless the entity has established its own mandatory auditor rotation requirement, there is no legal requirement for the mandatory rotation of auditors. The current auditor may be included in the auditor selection process at the end of the current audit services contract.

The GFOA *Recommended Practice – Audit Procurement (1996 and 2002)* provides that auditor independence would be enhanced by a policy requiring that the independent auditor be replaced at the end of the audit contract, as is often the case in the private sector. The *Recommended Practice* further states:

“Unfortunately, the frequent lack of competition among audit firms fully qualified to perform public-sector audits could make a policy of mandatory auditor rotation counterproductive. In such cases, it is recommended that a governmental entity actively seek the participation of all qualified firms, including the current auditors, assuming that the past performance of the current auditors has proven satisfactory.”

The United States Government Accountability Office (GAO), in a report titled, *Public Accounting Firms – Required Study on the Potential Effects of Mandatory Audit Firm Rotation*, issued in November 2003, concluded that such rotation may not be the most efficient way to strengthen auditor independence and improve audit quality considering the additional financial costs and the loss of institutional knowledge of the previous auditor. GAO further concluded that the potential benefits of mandatory audit firm rotation are hard to predict and quantify, but there is a fair certainty that there will be additional costs.

3. **Question:** If the entity is satisfied with the existing auditor and can negotiate acceptable fees, can the contract for annual financial audit services be renewed without ever going through the auditor selection procedures required by Section 218.391, Florida Statutes?

Answer: A contract for annual financial audit services can be renewed only as provided in the contract which is required to include a provision specifying the contract period, including renewals.

4. **Question:** Is an entity with an audit services contract that was in effect on the effective date of the revised auditor selection law, July 1, 2005, required to implement the revised auditor selection requirements on its first occasion for a need for audit services, or can that contract be continued?

Answer: An audit service contract that was in effect at July 1, 2005, can remain in effect through the end of the original contract term. However, if there was no contract in effect at July 1, 2005, the entity must apply the revised auditor selection procedures prior to the next need for an annual financial audit required by Section 218.39, Florida Statutes. Section 218.391(7), Florida Statutes, requires that a contract specify the contract period, including renewals, and conditions under which the contract may be terminated or renewed. If the contract in effect at July 1, 2005, is not in compliance with the requirements of Section 218.391, Florida Statutes, the entity must comply with the auditor selection and contractual provisions of the law prior to the next need for the entity to provide for an annual financial audit required by Section 218.39, Florida Statutes, unless such compliance cannot be achieved without violating the terms of the existing contract.

5. **Question:** Is it necessary to include renewal option provisions in audit services contracts entered into after July 1, 2005?

Answer: No. The contract is not required to include a renewal provision; however, a contract cannot be renewed in the absence of such a provision.

6. **Question:** Are the revised auditor selection procedures required to be used only when an entity decides to change auditors or initiate a request for proposals process?

Answer: No. The revised auditor selection procedures are required to be followed when an audit contract period expires. The audit contract is required to include a provision specifying the contract period, including renewals.

7. **Question:** If an existing contract is not in compliance with Section 218.391, Florida Statutes, may the governing body sign a new contract that is in compliance?

Answer: Yes, but the contract cannot be extended beyond the period specified in the existing contract, including renewals, without going through the auditor selection process required by Section 218.391, Florida Statutes.

8. **Question:** If the governing body of an entity chooses to select a firm other than the audit committee's highest recommended firm and documents the reason for not selecting the highest ranked firm as required by Section 218.391(4)(b), Florida Statutes, does the next ranked firm become the highest

ranked firm, requiring documentation as to the reason for non-selection, before a firm ranked lower than that firm can be selected?

Answer: The law does not specifically address this circumstance; however, it would be reasonable to assume that justification is necessary and should be documented for the selection of any firm over a higher ranked firm.

9. **Question:** If compensation is used as one of the factors to evaluate firms and the auditor selection is made in accordance with Section 218.391(4)(b), Florida Statutes, what documentation is required to justify selection of a firm other than the highest ranked firm?

Answer: Required documentation as to the reason for not selecting the highest ranked firm under Section 218.391(4)(b), Florida Statutes, is not described in the law. Such documentation could include a statement made by the governing board, possibly in the form of a resolution and included in the minutes of the governing board, describing the factors that caused the governing board to decide that selection of the next ranked firm was in the best interest of the entity. Those factors might include inability to negotiate a satisfactory contract with the highest ranked firm or information that has come to the governing board subsequent to the ranking process. However, as specified in Section 218.391(4)(c), Florida Statutes, the decision to select a firm cannot be based on compensation as the sole or predominant factor.

10. **Question:** If an auditor selection committee uses compensation as a ranking factor, may the governing body also use the alternative method to select the audit firm or must they use the method prescribed by Section 218.391(4)(b), Florida Statutes?

Answer: The alternative methodology referred to in Section 218.391(4)(c), Florida Statutes, refers to negotiation only. An alternative methodology for selection is not authorized in the law.

11. **Question:** If compensation is 20% of the ranking criteria and all other factors are each less than 20%, is compensation then the predominant factor, or must it be predominant of all factors combined, i.e., greater than 50% of all combined?

Answer: “Predominant” is not defined in the law with respect to auditor selection. Certainly, weighting compensation at greater than 50% of all combined factors, would constitute “predominant.” Black’s Law Dictionary defines “predominant” as “Something greater or superior in power and influence to others with which it is connected or compared.”

12. **Question:** Is there a minimum or maximum number of years that an audit contract must cover?

Answer: No. The audit services contract must specify a contract period including renewals, but the law does not specify a minimum or maximum number of years that an audit services contract must cover. This is left to the discretion of the

entity and is a matter of agreement between the entity and the audit firm. The entity should use prudent business practices in establishing the contract period.

13. **Question:** Section 218.391(4)(c), Florida Statutes, provides that a governing body may select a firm recommended by the audit committee and negotiate a contract with one of the recommended firms using an appropriate alternative negotiation method. Which specific provisions of the law may be considered non-mandatory under this provision by the application of an alternative methodology?

Answer: Regardless of the negotiation method used, a governmental entity must establish an audit committee pursuant to Section 218.391(2), Florida Statutes, and the audit committee must perform its functions in accordance with the requirements of Section 218.391(3), Florida Statutes. The authorization to use alternative procedures is in reference to the auditor negotiation procedures set forth in Section 218.391(4)(a), Florida Statutes. Regardless of the negotiation method used, compensation may not be the sole or predominant factor used to select the firm (Section 218.391(4)(c), Florida Statutes) and, if compensation is one of the factors used by the audit committee to evaluate the firms, the governing body must select the highest-ranked firm or document the reason for not selecting that firm (Section 218.391(4)(b), Florida Statutes).

Appendix C

Auditor Selection Resources

AICPA Audit Committee Toolkit: Government Organizations, American Institute of Certified Public Accountants, 1995 (www.aicpa.org/audcommctr/homepage.htm)

Audit Management Handbook, Stephen J. Gauthier, Government Finance Officers Association, 1989 (Note: Publication of this *Handbook* was discontinued several years ago as a result of 1996 changes to the Federal Single Audit Act and changes on GFOA policy; however, the references in these guidelines are consistent with current GFOA policy.)

Choosing an External Auditor – Guide for Making a Sound Decision, Mid-America Intergovernmental Audit Forum, March 2000 (www.auditforum.org/mid%20america/midam_exauditor.htm)

GFOA Recommended Practice - Audit Procurement (1996 and 2002), Government Finance Officers Association, 2002 (www.gfoa.org/services/rp/caafr/caafr-audit-procurement.pdf)

GFOA Recommended Practice – Audit Committees (1997, 2002, and 2006), Government Finance Officers Association, 2002 (www.gfoa.org/services/rp/caafr/caafr-establishment-audit-committees.pdf)

Government Accounting, Auditing, and Financial Reporting, Stephen J. Gauthier, Government Finance Officers Association, 2005

Guide to Audits of Local Governments, Carmichael, Douglas R., and Holder, William W., Practitioners Publishing Company, 20th Ed., January 2005

How to Avoid a Substandard Audit: Suggestions for Procuring an Audit, National Intergovernmental Audit Forum, May 1988 (www.ignet.gov/single/studies/prochand.txt)

Public Accounting Firms – Required Study on the Potential Effects of Mandatory Audit Firm Rotation, United States Government Accountability Office (GAO), November, 2003 (<http://www.gao.gov/new.items/d04216.pdf>)