

AN ORDINANCE **65899**

MAKING AND MANIFESTING A CONTRACT FOR  
A CONTINUOUS AUDIT OF CITY FINANCIAL  
STATEMENTS FOR FISCAL YEARS 1988 THROUGH  
1992, AND CONTAINING A THIRTY  
DAY CANCELLATION PROVISION.

\* \* \* \* \*

BE IT ORDAINED BY THE CITY COUNCIL OF THE CITY OF SAN ANTONIO:

SECTION 1. This ordinance makes and manifests a contract between the City of San Antonio, hereinafter called "City" and Price Waterhouse and Garza/Gonzalez and Associates, Certified Public Accountants, hereinafter called "Contractor", as follows:

- (a) Contractor, at his own cost and expense, shall furnish all labor, materials and accessories necessary and proper for the purpose, and at his own expense, shall make a general audit of the financial statements of the City, except those of the City Water Board, and the City Public Service Board for the fiscal year beginning October 1, 1987, and ending in fiscal year 1992, except that City or Contractor may at any time terminate this agreement and for the services hereunder upon giving thirty days written notice. Contractor agrees that this contract contemplates the engagement beginning prior to the close of each fiscal year, and early enough to insure completion of each of the five audits within but not to exceed one hundred and twenty (120) days in each case, after the close of the applicable fiscal year. Contractor is to examine the City of San Antonio financial statements for the five-year period and evaluate the fairness of presentation of the statements in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period. It is understood that these audits will be conducted in accordance with generally accepted auditing standards which will include a review of the system of internal control and tests of transactions to the extent necessary. Accordingly, they will not include a detailed audit of transactions to the extent which would be required if intended to disclose defalcations or other irregularities, although their discovery may result.

- (b) City agrees that it will maintain at least its present degree of conformance to the standards of the National Committee on Governmental Accounting pertaining to the recording of financial transactions and internal control, and that the contract price for each of the audits by Contractor as quoted in subsection (e), is predicated upon this conformance. City agrees that the preparation of the detail annual financial statements will be prepared by its Department of Finance as nearly as practical, in the manner and in accordance with the form outlined in "Municipal Accounting, Auditing, and Financial Reporting" published by the National Committee on Governmental Accounting. City further agrees that such financial statements and supplemental schedules which it prepares will be submitted to contractor in sufficient time (as completed) for full reconciliation with Contractor's findings, and to insure publication of the City's Annual Financial Report within one hundred and twenty (120) days after the close of each fiscal year. The City has the responsibility for the proper recording of transactions in the books of account, for the safeguarding of assets, and for the substantial accuracy of the financial statements. Such statements are the representations of management.
- (c) The examination will be made in accordance with generally accepted auditing standards adopted by the American Institute of Certified Public Accountants and the U.S. General Accounting Office "Standard for Audit of Governmental Organizations, Programs, Activities, and Functions, and Guidelines for Financial and Compliance Audits of Federally Assisted Programs and OMB Circular A-102, Attachment P and will include tests of accounting data and procedures we consider necessary in the circumstances. The objective of this examination is the expression of an opinion on the City's financial statements. Contractor's ability to express that opinion, and wording of the opinion will, of course, be dependent on the facts and circumstances at the date of the reports. If the opinion will be other than unqualified, the reasons therefore will be fully disclosed. The accountants' opinion will be signed by both Price Waterhouse and Garza/Gonzalez and Associates who will assume responsibility, both jointly and severally, for the examination of the financial statements of the City of San Antonio.
- (d) The City shall have completed and balanced all accounts and have prepared financial statements and schedules for all funds, and account groups to be examined by the contractor and shall provide the

Contractor with space deemed adequate by the Contractor for the efficient conduct of the examination. The City shall provide the Contractor, for his use and retention, with copies of these financial statements and schedules and shall provide the Contractor with trial balances of various funds, and account groups in a form acceptable to the Contractor.

- (e) In consideration of the faithful conformance and compliance with this contract, as described in the proposal, by the Contractor and the completion of the work herein stipulated, the City of San Antonio agrees and shall be and is hereby bound and obligated to pay to the Contractor, for such work a fee estimate of \$184,000 per year not to exceed \$214,000 per year as negotiated and submitted by the contractor.
- (f) Each month, the Contractor will submit a detailed statement (in a format satisfactory to the City) showing the nature and extent of the work done and the total amount due for the period. The contractor will also document any time invested by city staff and will adjust the fee accordingly. Upon receipt of such statement or report, the amount due will be paid by the City.
- (g) The City will review and approve the contractor's work plan, annual fee, adjustments for City staff participation, and all other conditions described in the proposal during May of each year to plan the examination of the City's Financial Statements.
- (h) The City agrees that all correspondence with the Contractor will be addressed to the principal firm with carbon copies submitted to the secondary firm.
- (i) The Contractor will comply with all laws and ordinances governing labor and relating to employers and employees and, all other things being equal, the Contractor shall use and employ San Antonio labor and material.

PASSED AND APPROVED this 15 day of October, 1987.

  
M A Y O R

ATTEST:

  
City Clerk

|                                   |   |
|-----------------------------------|---|
| AVIATION                          |   |
| BUDGET & RESEARCH                 | 1 |
| BUILDING INSPECTIONS              |   |
| BUILDING INSPECTIONS-HOUSE NUMBER |   |
| CITY WATER BOARD                  |   |
| CITY ATTORNEY                     |   |
| COMMERCIAL RECORDER               |   |
| CONVENTION & VISITORS BUREAU      |   |
| CONVENTION FACILITIES             |   |
| ECONOMIC & EMPLOYMENT DEVELOPMENT |   |
| EQUAL EMPLOYMENT OPPORTUNITY      |   |
| FINANCE DIRECTOR                  | 1 |
| ASSESSOR                          |   |
| CONTROLLER                        | 1 |
| TREASURY DIVISION                 |   |
| GRANTS                            |   |
| INTERNAL AUDIT                    |   |
| RISK MANAGEMENT                   |   |
| FIRE DEPARTMENT                   |   |
| HUMAN RESOURCES & SERVICES        |   |
| INFORMATION RESOURCES             |   |
| LIBRARY                           |   |
| MARKET SQUARE                     |   |
| METROPOLITAN HEALTH DISTRICT      |   |
| MUNICIPAL COURTS                  |   |
| PARKS & RECREATION                |   |
| PERSONNEL                         |   |
| PLANNING                          |   |
| POLICE DEPARTMENT                 |   |
| PUBLIC UTILITIES                  |   |
| PUBLIC WORKS                      |   |
| ENGINEERING                       |   |
| CENTRAL MAPPING                   |   |
| REAL ESTATE                       |   |
| TRAFFIC ENGINEERING               |   |
| PURCHASING & GENERAL SERVICES     |   |
| WASTEWATER MANAGEMENT             |   |
| ZONING ADMINISTRATION             |   |
| SPECIAL PROJECTS - CITY MANAGER   |   |

ITEM NO. 33  
DATE: OCT 15 1987

MEETING OF THE CITY COUNCIL  
MOTION BY: Thompson SECONDED BY: Wolff

ORD. NO. 65899 ZONING CASE \_\_\_\_\_

RESOL. \_\_\_\_\_ PETITION \_\_\_\_\_

|                                       | ROLLCALL | AYES          | NAYS |
|---------------------------------------|----------|---------------|------|
| MARIA BERRIOZABAL<br>PLACE 1          |          | ✓             |      |
| JOE WEBB<br>PLACE 2                   |          | <i>absent</i> |      |
| HELEN DUTMER<br>PLACE 3               |          | ✓             |      |
| FRANK D. WING<br>PLACE 4              |          | ✓             |      |
| WALTER MARTINEZ<br>PLACE 5            |          | ✓             |      |
| BOB THOMPSON<br>PLACE 6               |          | ✓             |      |
| YOLANDA VERA<br>PLACE 7               |          | ✓             |      |
| NELSON WOLFF<br>PLACE 8               |          | ✓             |      |
| WEIR LABATT<br>PLACE 9                |          |               | X    |
| JAMES C. HASSLOCHER<br>PLACE 10       |          | <b>ABSENT</b> |      |
| HENRY G. CISNEROS<br>PLACE 11 (MAYOR) |          | ✓             |      |

*Reason: Tris Stalderman  
Bany, Koyles*

**87-48**

APPROVED AS TO FORM:

2578 [Signature]  
City Attorney

APPROVED AS TO FUNDS:

\_\_\_\_\_  
Director of Finance

The above contract accepted in all things and executed  
this 23RD day of DECEMBER, 1987.

Garza/Gonzalez & Assoc's.

BY:

TITLE:

[Signature]  
Partner

Price Waterhouse

BY:

TITLE:

[Signature]  
Partner

AN ORDINANCE **65899**

*REVISED*

MAKING AND MANIFESTING A CONTRACT FOR  
A CONTINUOUS AUDIT OF CITY FINANCIAL  
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- (b) City agrees that it will maintain at least its present degree of conformance to the standards of the National Committee on Governmental Accounting pertaining to the recording of financial transactions and internal control, and that the contract price for each of the audits by Contractor as quoted in subsection (e), is predicated upon this conformance. City agrees that the preparation of the detail annual financial statements will be prepared by its Department of Finance as nearly as practical, in the manner and in accordance with the form outlined in "Municipal Accounting, Auditing, and Financial Reporting" published by the National Committee on Governmental Accounting. City further agrees that such financial statements and supplemental schedules which it prepares will be submitted to contractor in sufficient time (as completed) for full reconciliation with Contractor's findings, and to insure publication of the City's Annual Financial Report within one hundred and twenty (120) days after the close of each fiscal year. The City has the responsibility for the proper recording of transactions in the books of account, for the safeguarding of assets, and for the substantial accuracy of the financial statements. Such statements are the representations of management.
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- (d) The City shall have completed and balanced all accounts and have prepared financial statements and schedules for all funds, and account groups to be

examined by the contractor and shall provide the Contractor with space deemed adequate by the Contractor for the efficient conduct of the examination. The City shall provide the Contractor, for his use and retention, with copies of these financial statements and schedules and shall provide the Contractor with trial balances of various funds, and account groups in a form acceptable to the Contractor.

- (e) In consideration of the faithful conformance and compliance with this contract, as described in the proposal, by the Contractor and the completion of the work herein stipulated, the City of San Antonio agrees and shall be and is hereby bound and obligated to pay to the Contractor, for such work a fee not to exceed estimate submitted by contractor as outlined below:

|      |           |
|------|-----------|
| 1988 | \$151,750 |
| 1989 | 156,000   |
| 1990 | 157,000   |
| 1991 | 165,000   |
| 1992 | 175,000   |

- (f) Each month, the Contractor will submit a detailed statement (in a format satisfactory to the City) showing the nature and extent of the work done and the total amount due for the period. Upon receipt of such statement or report, the amount due will be paid by the City.
- (g) The City agrees that all correspondence with the Contractor will be addressed to the principal firm with carbon copies submitted to the secondary firm.
- (h) The Contractor will comply with all laws and ordinances governing labor and relating to employers and employees and, all other things being equal, the Contractor shall use and employ San Antonio labor and material.

PASSED AND APPROVED this 15 day of October, 1987.

  
M A Y O R

ATTEST:

City Clerk

APPROVED AS TO FORM:

*Tom Givley*  
City Attorney

APPROVED AS TO FUNDS:

Director of Finance

The above contract accepted in all things and executed  
this \_\_\_\_\_ day of \_\_\_\_\_, 1987.

BY: \_\_\_\_\_

TITLE: \_\_\_\_\_

BY: \_\_\_\_\_

TITLE: \_\_\_\_\_

# CITY OF SAN ANTONIO

## Interdepartment Correspondence Sheet

TO: Mayor and Members of the City Council  
FROM: Yolanda Vera, Chair of Audit Committee  
COPIES TO: File  
SUBJECT: Audit Contract

Date October 14, 1987

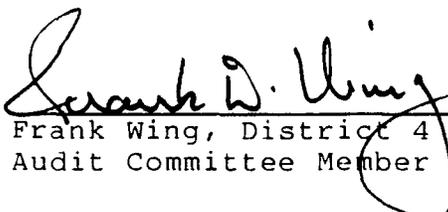
The Audit Committee has completed its mission after almost three months of work.

Attached is a listing of the Audit Proposals received together with a summary of pertinent data relating thereto. A majority of the committee recommends Deloitte Haskins & Sells/Sifuentes, Martinez & Co.

Also, attached is a schedule illustrating the steps that the Audit Committee took in arriving at its recommendation.

In addition, to the selection process, the committee reviewed the City's policy of rotating accounting firms every 5 years and after careful consideration it is the Audit Committee's recommendation that this policy be continued for the following reasons:

- (1) It is appropriate to rotate both accounting firms when there is more than one qualified accounting firm in the city expressing an interest in doing the audit.
- (2) The auditor's independence may be strengthened by the rotation of accounting firms. The entire community of taxpayers and administration is dependent upon a high degree of independence.
- (3) The 5 year period is considered to be the optimum length for the contract period because it results in lower overall costs and superior performance and efficiency.

  
\_\_\_\_\_  
Frank Wing, District 4  
Audit Committee Member

  
\_\_\_\_\_  
Yolanda Vera  
Chairperson of Audit Committee

  
\_\_\_\_\_  
Weir Labatt, District 9  
Audit Committee Member

Request For Proposals  
Audit Contract  
Timetable

| <u>Steps</u> | <u>Date</u>     | <u>Action</u>  |
|--------------|-----------------|--|
| I            | July 29th       | Review & Approval of RFP by Audit Committee  |
| II           | July 31st       | Mail RFP's to all Accounting Firms in San Antonio                                    |
| III          | Aug. 28th       | RFP's submitted to City by Accounting firms  |
| IV           | Aug. 28-Sept. 4 | Evaluation of Proposals by Staff   |
| V            | Sept. 8         | Staff report to committee summarizing proposals                                      |
| VI           | Sept. 23        | Committee reviews Proposals and establishes procedures for finalizing recommendation |
| VII          | Oct. 1          | Interviews of firms by Audit Committee   |
| VIII         | Oct. 13         | Audit Committee recommendation formalized  |
| IX           | Oct. 15         | Recommendation to Council  |

# CITY OF SAN ANTONIO

## Interdepartment Correspondence Sheet

TO: Yolanda Vera, Chairperson, of Audit Committee

FROM: Carl L. White, Director of Finance

COPIES TO: File

SUBJECT: Independent Auditor Negotiations

Date December 2, 1987

The purpose of this memo is to close the loop with the Audit Committee by reporting to the Committee the results of our negotiations with the auditors selected by Council on October 15, 1987. Pursuant to direction of the Council we were to work with the Auditors, Price Waterhouse - Garza Gonzalez & Associates (P.W./G.G.), to quantify the number of hours that the City's Internal Audit staff could devote to the independent auditors to reduce the cost of the annual audit to the City.

After several meetings between City staff and representatives from both auditing firms, it was agreed that the annual audit fee could be reduced by 350 hours or approximately \$21,000. It was also understood that these 350 hours are not in addition to what Internal Audit has assisted in the past.

A review of the October 15 Council meeting transcript implies that the City Council assumed that the fee negotiated would reduce the fee to a level which would compare favorably to the low fee estimate submitted. A reduction of \$21,000 reduced the P.W./G.G. proposal to an annual estimated fee of \$184,000 to \$214,000, ranking their proposal third in terms of estimated fee.

If the foregoing arrangement is satisfactory to the Audit Committee, please let us know so that we may proceed to finalize the contract and ordinance, accordingly.

  
\_\_\_\_\_  
Carl L. White  
Director of Finance

Approved:

  
\_\_\_\_\_  
Alexander E. Briseno  
Assistant City Manager

RECEIVED  
CITY OF SAN ANTONIO  
FINANCE DIRECTOR'S OFFICE

1987 NOV -6 AM 9 21

Garza Gonzalez & Associates  
Price Waterhouse

November 3, 1987

Mr. Carl White  
Director of Finance  
City of San Antonio  
P.O. Box 9066  
San Antonio, Texas 78285

Dear Mr. White:

It was a pleasure meeting with you and with the other members of your staff on October 28, 1987, to discuss the audit contract ordinance. Based on our discussions with you and subsequently with Mr. John Small, Internal Audit Division Director, we will adjust the estimated hours for the annual examination of your financial statements and thus the estimated fee.

We are prepared to assign from 300 to 350 hours of specific auditing tasks to your Internal Audit staff for each annual examination. These directly assisted audit hours will adjust our annual estimated fee to approximately \$184,000 to \$214,000. We do not expect the annual fee to exceed \$214,000. Also, please keep in mind that we will bill you only for actual hours invested. If our actual hours invested are less than estimated we will adjust our billings accordingly.

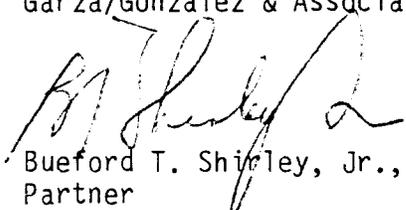
We hope this meets with your approval and that the audit contract ordinance can be prepared from the information provided herein.

If you have any questions in regards to this, please advice.

Sincerely,



Rene E. Gonzalez, CPA  
Partner  
Garza/Gonzalez & Associates



Bueford T. Shirley, Jr., CPA  
Partner  
Price Waterhouse

212 Stumberg, Suite 208  
San Antonio, TX 78204  
512/227-1389

One Riverwalk Place, Suite 900  
San Antonio, TX 78205  
512 226-7700

RECEIVED  
CITY OF SAN ANTONIO  
FINANCE DIRECTOR'S OFFICE

Garza Gonzalez & Associates  
Price Waterhouse

1987 DEC 4 PM 1:58

December 3, 1987

Mr. Carl White  
Director of Finance  
City of San Antonio  
P. O. Box 9066  
San Antonio, Texas 78285

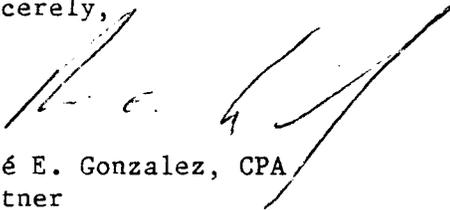
Dear Mr. White:

To confirm and document our discussion of yesterday relating to the audit contract ordinance, our joint venture team will meet with you during May of each year to plan the examination of the City's Financial Statements. At that time, we can better assess the involvement of the Internal Audit Staff in relationship to the annual examination.

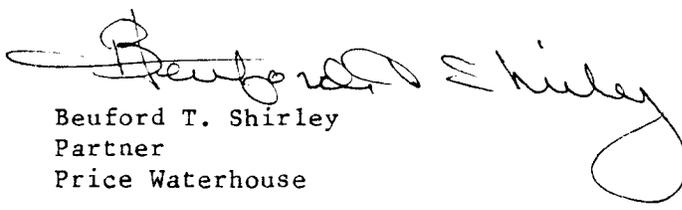
We are willing to reduce our time and thus your cost, by any time invested by your staff. If your staff can assist us during the examination and thus reduce our time we will adjust our fees accordingly. We will bill you for the actual hours invested by our firms at the hourly rates stated in our proposal.

We look forward to a long and favorable relationship.

Sincerely,



René E. Gonzalez, CPA  
Partner  
Garza/Gonzalez & Associates



Beuford T. Shirley  
Partner  
Price Waterhouse

| <u>Firms</u>              | <u>Has firm performed City Audit &amp; When</u> | <u>Exper. w/ FAMIS</u> | <u>Prof. staff locally</u> | <u>Internal Audit Asst/Hrs.</u> | <u>Fee 1988</u>  | <u>Fee 1989</u> | <u>Fee 1990</u> | <u>Fee 1991</u> | <u>Fee 1992</u>        |
|---------------------------|---|------------------------|----------------------------|---------------------------------|--|-----------------|-----------------|-----------------|------------------------|
| Arthur Young & Co         | No***   | Yes****                | 100+                       | 1,050                           | \$201,900  | \$212,526       | \$223,712       | \$235,486       | \$247,880 <sup>a</sup> |
| Ruben Flores, Jr. & Co.   | No  | Yes****                | 4/3CPA's                   |                                 |  |                 |                 |                 |                        |
| Deloitte Haskins & Sells  | Yes - 1972-1976                                 | Yes                    | 32                         | 1,500                           | 151,750  | 153,000         | 157,000         | 165,000         | 175,000                |
| Sifuentez, Martinez & Co. | No  | No                     | 6/4CPA's                   |                                 |  |                 |                 |                 |                        |
| Ernst & Whinney           | Yes - 1961-1966                                 | No                     | 142                        | 2,000                           | 176,000  | 178,000         | 184,000         | 193,000         | 202,000                |
| Romo & Co.                | No  | No                     | 4/2 CPA's                  |                                 |  |                 |                 |                 |                        |
| KPMG Peat Marwick         | No*   | Yes                    | 90                         | 1,100                           | 168,000  | 165,000         | 161,000         | 153,000         | 158,000                |
| Leal, Carter & Rocha      | Yes - 1978-1982                                 | Yes                    | 7/3 CPA's                  |                                 |  |                 |                 |                 |                        |
| Garcia Penchan & Co.      | No  | No                     | 5/4 CPA's (avg)            |                                 |  |                 |                 |                 |                        |
| Price Waterhouse          | No  | No                     | 31                         | 0                               | between \$205,000 & \$235,000 over the 5 year period                           |                 |                 |                 |                        |
| Garza/Gonzalez            | Yes - 1983-1987                                 | Yes                    | 14/5 CPA's                 |                                 |  |                 |                 |                 |                        |
| Touche Ross               | Yes - 1978-1982                                 | Yes                    | 23                         | 400                             | \$173,000 to \$185,000 + published annual local inflation factors of each year |                 |                 |                 |                        |
| Michael Garza & Asso.     | No  | Yes                    | 5/4 CPA's                  |                                 |  |                 |                 |                 |                        |

\*Although Peat Marwick has never performed the City audit, they have and continue to perform a significant amount of consulting work for the City particularly in the Wastewater Department.

\*\*Fees for each year 1989-1992 will increase based on an inflation factor (CPI-U) limited to 5% assuming no significant changes in the scope of the engagement. The numbers listed above assume a maximum increase of 5% compounded annually.

\*\*\*This firm performed the Police Department Management Study in 1984/85.

\*\*\*\*Personnel currently with these firms worked with the initial designers of FAMIS in the 1960's; and audited FAMIS in the 1970's and 1980's while employed by other firms who have performed the City Audit.

GAO

Report to the Chairman, Legislation and  
National Security Subcommittee, House  
Committee on Government Operations,  
House of Representatives

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August 1987

# CPA AUDIT QUALITY

## A Framework for Procuring Audit Services



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# Executive Summary

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## Purpose

The federal government administers domestic assistance programs with outlays exceeding \$100 billion per year through state and local governments. The recipients of these funds are required to be audited and often contract directly with nonfederal auditors—mostly certified public accountants (CPAs)—for audits. These audits help ensure that federal funds are used for intended purposes and that recipients administer their programs in compliance with all applicable laws and regulations. Each year, these federal fund recipients pay CPAs between \$100 and \$200 million to perform these audits, and this amount will increase with full implementation of the Single Audit Act of 1984, which will increase the number of entities required to obtain audits of their federal funds.

In April 1986, Representative Jack Brooks, Chairman, Legislation and National Security Subcommittee, House Committee on Government Operations, asked GAO to evaluate the procedures used by state and local officials to obtain the services of public accounting firms. Mr. Brooks' request resulted from earlier hearings on CPA audit quality, which revealed significant problems with such audits. Specifically, Mr. Brooks asked GAO to assess whether a relationship exists between the way these officials procure audit services and the quality of audits that result. He also requested that GAO make recommendations for correcting any weaknesses in current procurement procedures and for ensuring healthy price competition among firms interested in performing governmental audits.

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## Background

Since 1985, both GAO and the American Institute of Certified Public Accountants (AICPA) have cited concerns about the quality of audits of governmental units and factors that adversely affect audit quality. Over the last 2 years, GAO has issued two reports<sup>1</sup> addressing CPA audit quality which indicated that CPAs did not satisfactorily comply with professional auditing standards in many cases. A recent AICPA task force report confirmed GAO's concerns with audit quality and concluded that procurement was one of several contributing factors and recommended that a study be undertaken of the procurement of audit services and the way in which that process influences audit quality.

In this review, GAO determined whether an identifiable relationship exists between the process used to procure audit services from CPAs and

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<sup>1</sup>CPA Audit Quality: Inspectors General Find Significant Problems (GAO/AFMD-86-20, December 5, 1985) and CPA Audit Quality: Many Governmental Audits Do Not Comply With Professional Standards (GAO/AFMD-86-33, March 19, 1986).

- 
- use specific technical factors in selecting a qualified audit firm,
  - prepare written agreements which hold both the entity and the audit firm accountable,
  - consider using multiyear agreements, preferably of a 5-year duration,
  - obtain financial officials—qualified personnel with specialized knowledge of governmental accounting and auditing—to assist in planning and implementing their procurement processes, and
  - consider the benefits of using audit committees both to help plan and to oversee entities' procurement processes. (See chapters 2 and 3.)

In addition, GAO endorses the formulation of detailed procurement guidance as an important vehicle to improving audit quality. The results of GAO's work should be useful in this effort. GAO believes the guidance can be best accomplished by all interested organizations working together under the auspices of an intergovernmental organization facilitating the project or by GAO leading the project with the assistance of an advisory committee. (See chapter 4.)

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## Agency Comments

During the review, the views of experts in the fields of accounting, auditing, and contracting were sought, and are incorporated in the report where appropriate. However, as agreed with the requester's office, GAO did not obtain formal comments from federal agency inspectors general, contracting entities, or the public accounting profession on this report.

In addition to state and local laws and regulations, entities receiving many types of federal assistance should follow attachment O, "Procurement Standards," of either OMB circular A-102,<sup>1</sup> or OMB circular A-110,<sup>4</sup> in procuring audit services. These guidelines discuss basic procurement principles, such as obtaining competition, and the appropriateness of various procurement methods. In applying the standards contained in the circulars, some entities have considerable latitude which allows them to employ a variety of techniques to obtain audit services. These techniques are discussed in chapters 2 and 3 of this report.

Traditionally, entities have procured audit services through formal advertising and competitive negotiation. In formal advertising, the entity issues precise, tailored specifications and awards the contract to the lowest responsive bidder. This method is only viable when the services are so well-defined that selection of an audit firm can appropriately be made on the basis of price alone. The complexity of most audits, however, usually requires that solicitation methods using factors other than cost be considered.

Competitive negotiation has therefore been the preferred method for obtaining audit services because it is flexible enough to take price into account but permits the entity to make informed choices given the marketplace. Competitive negotiation allows an entity to trade off features of experience, quality, qualifications, and value and to take advantage of unique talents and proposals that might be offered and tailored precisely to the entity's needs. The framework for procuring audit services addressed in this report is consistent with this method of procurement.

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## Objectives, Scope, and Methodology

Our objectives in this review were to (1) determine whether an identifiable relationship exists between the process entities use to procure audit services from CPAs and the resulting quality of the audit, (2) make recommendations to correct any weaknesses in current procurement procedures and to ensure healthy price competition among firms bidding for audit contracts, and (3) develop a framework that specifies criteria for an effective procurement process. This framework is used in this study to make the comparison in the first objective and to identify weaknesses in current procurement procedures, as noted in the second objective.

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<sup>1</sup>"Uniform Requirements for Assistance to State and Local Governments" (January 1, 1981).

<sup>4</sup>"Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-profit Organizations" (July 1, 1976).

# Procurement Practices Relate to Audit Quality

Based upon our review results, we found that the process an entity follows to engage its auditor significantly relates to the quality of the audit and the final report. Thus, entities need to use a procurement process that strives for a quality audit at a reasonable cost. Through our ongoing process of discussions and validations with experts, we have identified four critical attributes that comprise the framework of a procurement process. They are

- competition,
- solicitation,
- technical evaluation, and
- written agreement.

These four attributes provide a framework that, if followed, should substantially improve the procedures entities use to obtain audit services at a reasonable cost and ultimately improve the quality of their auditors' work. The detailed criteria we developed to evaluate whether entities used these attributes to procure their audits are discussed in detail later in this chapter.

The entities' responses to our questionnaire, when compared against the procurement criteria, showed that 58 percent of the entities in our universe did not meet the criteria for all four attributes. While some entities may have met one or more of the criteria, it was necessary to meet all four attributes to be considered to have an effective procurement for purposes of our analyses. Our data also showed that these entities received unacceptable quality audits from their CPAs in 46 percent of their engagements. On the other hand, for entities which met the procurement criteria based on their questionnaire responses, the likelihood of receiving an unacceptable audit decreased to 17 percent. Figure 2.1 illustrates these results. Throughout this chapter, we use the terms "effective" and "ineffective" to indicate when an entity did or did not meet our criteria.

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**Multiyear Agreements**

We believe that competition can be obtained, while concurrently realizing the benefits of lower cost and efficiency, when an entity uses multiyear agreements. Such an agreement involves the entity engaging its auditor for more than 1 year at a time.

In discussions with us, many of our experts stated that multiyear contracts not only provided an incentive for an audit firm to devote time to submitting a well-developed proposal and to establish its learning curve in the early years of the engagement but also minimized staff resources the entity spent on procuring audit services. In addition, according to experts, the audit firm recovers some of its costs and realizes a profit in the second, third, or fourth year of the engagement. Further, two CPAs on our panel stated that their firms could minimize the risk of producing a poor quality audit and make the greatest contribution to improving program and financial operations in the final years of their multiyear agreements. This is due, in their opinion, to the knowledge a firm can acquire over a period of time while performing an audit.

During our study, we found that some entities engaged in multiyear agreements. These multiyear agreements normally provided for annual contract renewal at the entity's option—usually contingent upon the audit firm performing acceptable quality work. Although there was some disagreement as to the ideal length of a multiyear agreement, most of the experts we spoke with indicated a range of from 3 to 5 years. We agree that entities should consider using multiyear agreements, preferably of a 5-year duration, due to the potential cost savings and continuity benefits over the long-term.

We also asked experts to discuss the advantages and disadvantages of rotating audit firms once the multiyear contract period expired and the entity had to rebid the audit engagement. We found that opinions varied greatly as to whether the current audit firm should be allowed to submit a proposal. Those experts who favored rotation stated that they believed it was advantageous for the entity to obtain a “new perspective” from a different audit firm.

On the other hand, others stated that firms commonly assigned different staff to these audit engagements as a result of attrition or the unavailability of prior staff to work on the current-year audit. In these cases, experts felt that rotation of staff within the firm was sufficient to provide a new perspective, therefore eliminating the need to ban the current auditor from submitting a proposal. Regardless of how an entity

engages its auditor, it should consider the benefits of rotation and establish a policy regarding its use when appropriate.

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**Solicitation—  
Communicating Audit  
Requirements**

The solicitation process addresses the manner in which the entity communicates its needs and requirements to potential bidders. When an entity uses an effective solicitation as part of its procurement process, it assures itself that all audit firms clearly understand the requirements of the audit and submit comprehensive proposals that can be evaluated on an equitable basis. Based upon the solicitation criteria, entities were more apt to obtain a quality audit when their solicitation process was formal and comprehensive and accurately conveyed all of the details and audit requirements to the audit firms.

We believe that effective planning can help ensure a more comprehensive solicitation process. Entities can plan their process by deciding on the provisions to include in their solicitation document, time frames for audit firms to respond to the solicitation, and the manner in which they would respond to follow-up questions from the CPAs.

Because the complexity and requirements of audits vary among entities, the criteria for an effective solicitation process—as developed for this report—allows for flexibility. Therefore, for an entity to meet the criteria for solicitation, we, in consultation with our panel of experts, decided that it had to include at least four items in its communication with potential bidders. For example, at least two of these items had to address background information on the entity, the period to be audited, auditing standards to be followed, the types of reports required, or the specific audit guide or program to be followed. (Appendix IV includes a detailed list of provisions that entities may include in their solicitation documents.)

**Meeting Solicitation Criteria  
Could Improve Audit Quality**

Entities can improve the likelihood of receiving a quality audit if their solicitation process meets the criteria established during this review. Our analysis of the questionnaire responses showed that 29 percent of the entities in our universe did not meet the solicitation criteria and received unacceptable quality audits 55 percent of the time. On the other hand, 71 percent of the entities met the solicitation criteria and had unacceptable quality audits 25 percent of the time.

Figure 2.5 provides a comparison of the percent of times entities in our universe met the solicitation criteria and the quality of resulting audits.

In addition to entities having effective methods for providing prospective firms with information at the outset of the procurement process, we found that many of the entities which met the solicitation criteria also had procedures to provide follow-up information or clarifications to potential bidders when requested. This was often done in group meetings with all bidders, through written communication with the bidders, in separate communications directly with the audit firms, or informally through telephone responses to direct inquiries by various CPAs. We believe that where information is provided in response to CPAs' inquiries, however, it should be disseminated to all audit firms to ensure all proposals are based on the same information, thus ensuring fairness.

As stated earlier, we believe it is ultimately the CPA's responsibility to perform a quality audit. Therefore, in cases where the entity's solicitation process does not properly communicate all of the requirements of the engagement or the stated requirements are vague, the CPA must obtain this information before the final audit report is submitted, but preferably even before the contract document is prepared and the audit commences.

Figure 2.6, on the following page, highlights the solicitation methods used by entities in our sample which met the solicitation criteria. The charts show entities' methods for engagements of various sizes.

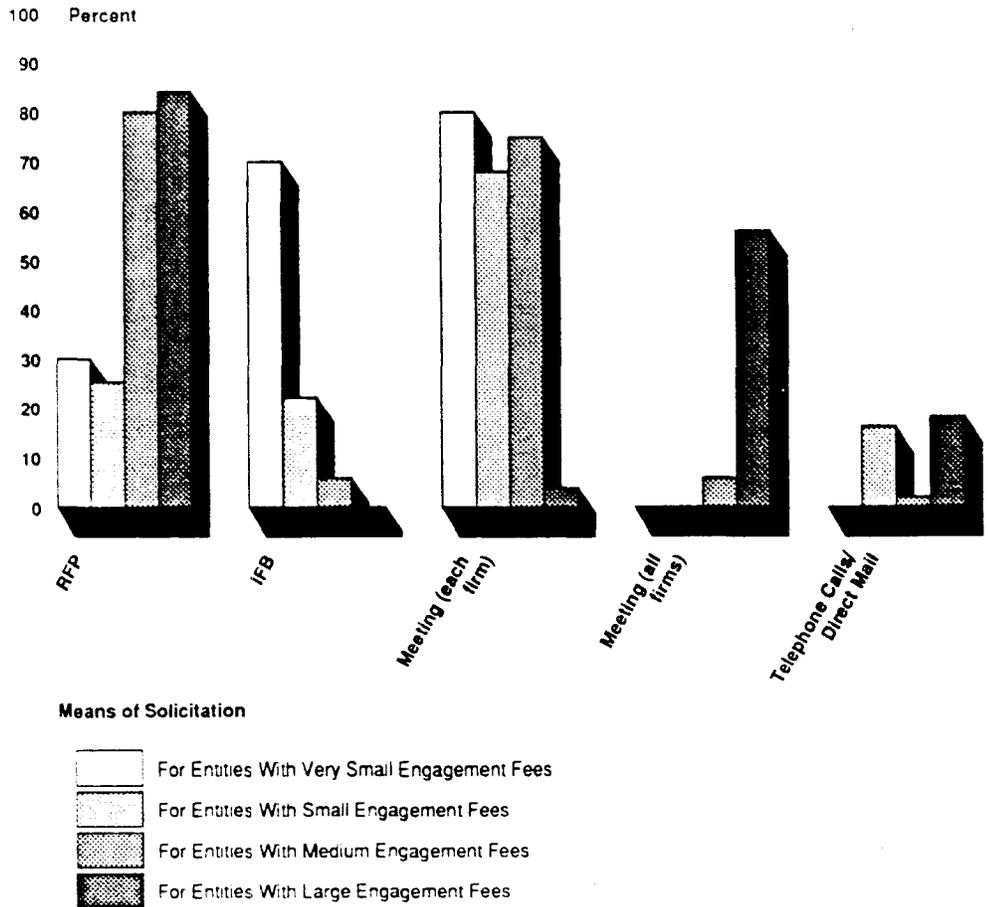
Appendix III includes selected examples of how entities engaged their auditors. One describes how the entity's solicitation process may have contributed to it receiving an unacceptable quality audit. In another example, the CPA may have effectively mitigated potential audit problems that could have resulted from a vague or incomplete solicitation document.

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### **Technical Evaluation— Selecting a Qualified Auditor**

The technical evaluation process requires that an entity devise a method for evaluating the merits of each audit firm's technical proposal and for selecting the CPA firm that can provide a quality audit at a fair price. The technical evaluation process focuses on the auditors' skills, experience, commitment, and understanding of the audit requirements—factors which are then considered in selecting the best audit firm. Based on questionnaire responses, we found that many entities (1) screened potential bidders to determine those that possess basic or mandatory qualifications, (2) developed adequate technical evaluation factors, other than cost, to assess CPAs' proposals, and (3) applied these factors, first technical then cost, to select a winner.

**Figure 2.6: Various Solicitation Methods Used by Entities in Our Sample by Size of Engagement**



- Notes:**
1. Pertains to entities which met the competition criteria.
  2. Very small (under \$1,000), small (\$1,000-\$10,000), medium (\$10,000-\$75,000), and large (over \$75,000)
  3. Percentages do not equal 100 because entities may use more than one method
  4. Meetings may be used as the single method of solicitation or in addition to an RFP or IFB.

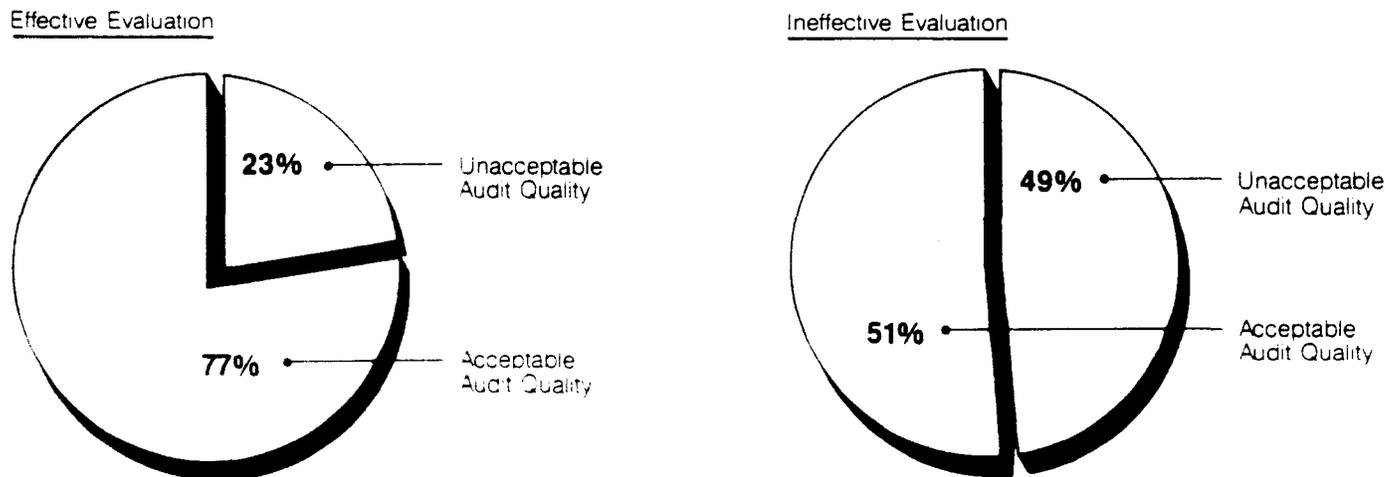
As stated previously, because the complexity and requirements of audits vary among entities, the criteria for an effective technical evaluation allow for flexibility. For an entity to meet the criteria for technical evaluation, we, in consultation with our panel of experts, decided that the entity had to indicate in the questionnaire that it considered at least three technical factors, other than cost, in its selection process. At least one of these had to be the firm's technical approach to performing the

audit, the qualifications and technical backgrounds of staff to be assigned to the engagement, or the firm's past governmental or industry experience.

### Meeting Technical Evaluation Criteria Could Improve Audit Quality

Results of our review indicate that when entities meet the technical evaluation criteria they are more likely to receive a quality audit. Based on our analysis of questionnaire responses, we found that 43 percent of the entities in our universe did not meet the criteria for technical evaluation. These entities received unacceptable quality audits 49 percent of the time, while entities in our universe which met the technical evaluation criteria received unacceptable quality audits 23 percent of the time. Figure 2.7 compares the frequency of acceptable and unacceptable audit quality when an effective technical evaluation was performed and when it was not.

**Figure 2.7: Effective and Ineffective Technical Evaluation and Related Audit Quality**



Further, table 2.1 illustrates how an entity can increase the likelihood of obtaining an acceptable audit when it includes adequate technical criteria, in addition to cost, in its selection process.

**Table 2.1: Frequency of Acceptable Audits Based on Type of Criteria Used To Evaluate Bidders**

| Type of criteria   | Frequency of acceptable audit (percentage) |
|--|--|
| Cost was only consideration  | 10   |
| Consideration given to technical factors, but not sufficient to meet the technical evaluation criteria | 51   |
| Consideration given to technical factors sufficient to meet the technical evaluation criteria          | 77   |

Prior to receiving technical proposals, entities meeting the technical evaluation criteria indicated that they developed procedures and technical criteria for evaluating proposals which considered the firms' qualifications as well as cost. The criteria could have considered such items as the auditors' skills, experience, commitment, and understanding of the audit requirements. The criteria should be conveyed to proposers, if only in general terms, to allow the firms to emphasize their particular strengths in their technical proposals. Further, the entity should make its final selection consistent with established evaluation procedures by evaluating each firm's strengths and weaknesses and ensuring that all qualified firms are fairly considered.

The extent and type of technical criteria used in the evaluation process can vary depending on the complexity of the engagement and extent to which the audit firms have been "prequalified." In addition to items included in the technical evaluation criteria, as discussed earlier, entities in our universe included factors such as

- the size and location of the firm,
- the range of activities performed by the firm,
- the firm's participation in training and continuing professional education in auditing governmental programs,
- a description of the firm's quality control procedures,
- results of internal and external quality control reviews of the firm,
- the firm's supervisory and review procedures,
- time frames for the fieldwork to commence and be completed,
- the firm's data processing capabilities, and
- the amount of assistance the firm expects from the entity.

Several sources, including the Western Intergovernmental Audit Forum in its May 1986 Guidelines for Preparation of Requests for Audit Proposals, suggest that an entity apply values to technical criteria factors

to identify qualified firms. By weighing selection criteria by relative importance in advance, the entity avoids later criticism of unfair selection methods and ensures equitable evaluation of all proposers. Most experts believe that only after an entity narrows the field of qualified firms to those which meet the technical criteria, should "cost" then be considered in the final selection.

We believe that the auditor selection process requires many subjective judgments. We agree that each firm's technical strengths should first be evaluated and ranked on the basis of the technical criteria before factoring in cost or price to arrive at a final selection. If an audit firm is judged not to be technically qualified to perform the audit, then it should not be selected, regardless of its cost proposal, because the risk of performing a poor quality audit is greatly increased.

Appendix III includes selected examples of instances where entities' selection of the winning audit firm was based on cost only, which may have contributed to their receiving an unacceptable quality audit.

### Qualifying Audit Firms

In discussions with some contracting entities early in our review, we found that in an effort to make their evaluation process more efficient, entities sometimes eliminated many unqualified firms early in the evaluation process. They stated that they most often did this by requiring audit firms to meet preestablished mandatory criteria for their proposals to be judged minimally technically acceptable and to be considered for further evaluation. Where not precluded by law or regulation, entities may use a "request for qualifications," which is a screening device that ensures that only qualified firms are sent the solicitation document. By eliminating firms early, the entity is spared from applying the more time-consuming technical evaluation criteria to firms which do not appear to be qualified to perform the audit.

To meet mandatory criteria, for example, an audit firm might have to (1) affirm that it is licensed to practice in the applicable state, (2) affirm that its staff meets the independence standard outlined in generally accepted government auditing standards, (3) affirm that its staff does not have a record of poor-quality work, (4) maintain its resources and office locations which will potentially do the work within a reasonable distance of the entity, and (5) provide evidence of an independent review with a positive outcome. We believe that these mandatory criteria are items that, if included in an entity's technical evaluation process,

period of time, to assist in monitoring the audit firm, (3) obtain volunteers from local professional and educational organizations to assist the entity, and (4) communicate with the appropriate RIG about the results of its desk review and possible quality control review of the CPA's audit.

The last example in appendix III illustrates the importance of monitoring contract performance.

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## **Conclusions and Recommendations**

As discussed in the previous sections, our analysis of questionnaire responses indicates that there is a strong relationship between procurement and audit quality. It further indicates that entities are much more likely to receive acceptable quality audits when they employ a procurement process that meets the criteria for each of the four attributes as described in this report. However, we believe that entities are not taking steps to ensure that they have an effective procurement process. As a result, entities are almost three times more likely to receive an unacceptable quality audit.

Accordingly, we recommend that entities carefully assess their procurement practices and take actions to include the framework established in this report to better assure themselves of obtaining qualified auditors at a reasonable cost. The following recommendations for improving current procurement procedures are not intended to supercede existing state or local law or regulation. Instead, entities should consider these recommendations in light of their own legal and administrative requirements and incorporate them where feasible. Specifically, we recommend that entities:

- Ensure that at least two audit firms are considered when selecting a qualified auditor. Where feasible, entities should obtain competition in all circumstances, except when exercising renewal options on multiyear contracts.
- Provide multiyear contracts when possible, preferably for 5 years, to the winning audit firm to benefit from the auditor's learning curve and experience and to take advantage of cost savings associated with not procuring audit services on an annual basis. However, once the contract period expires, entities should rebid to ensure that they receive a qualified auditor at a reasonable price. The entities must also decide whether they will permit their current auditor to submit a proposal for the upcoming audit.

- Ensure that their solicitation—whether it is a request for proposal, invitation for bid, or other method—is comprehensive and that all requirements for the audit engagement are communicated to interested audit firms.
- Ensure that they use specific technical factors in selecting a qualified audit firm. Entities should include items such as the audit firm’s past governmental or industry experience, the firm’s technical approach to performing the audit, and/or the qualifications of individual staff assigned to the engagement.
- Ensure that the technically qualified firm performs the audit engagement, at a price competitive with that of similarly qualified firms. In selecting an auditor, where entities are not required to procure on cost alone, cost should be one of the factors in selecting a CPA, but should not override a firm’s technical qualifications.
- Prepare a written agreement, signed by the entity and the audit firm, which includes provisions that hold both the entity and the firm accountable. For example, a firm may have to deliver an audit report by a specified date, and the entity may have to have its financial records in auditable condition. This can usually be accomplished through a complete statement of work, which specifies the terms and scope of the engagement, the product or “deliverables,” the engagement fee, and time and legal requirements. It should also contain provisions in the case of poor performance or nonperformance of the contract. An engagement letter may substitute for a written contract but should contain all of the provisions that protect the entity, in addition to the audit firm.
- Ensure that some monitoring techniques are employed so that the entities obtain the services they are paying for or are in a position to take recourse if the audit is of unacceptable quality.