

COUNCIL ACTION FORM

SUBJECT: **AUDITING SERVICES CONTRACT**

BACKGROUND:

Eide Bailly, LLP has provided financial audit services for the City since the fiscal year that ended June 30, 2003. The current agreement ended with the fiscal year 2011/12 audit. The City is seeking an agreement to audit the financial statements for the fiscal year that ended June 30, 2013, with an option of auditing the financial statements for the subsequent four fiscal years.

Best practices for audit services provided by the Government Finance Officers Association (GFOA) recommend that governmental entities enter into multi-year agreements of at least five years in duration, which allows for greater continuity and helps to minimize the potential for disruption in connection with the independent audit. Multi-year agreements also help auditors spread start-up costs over several years rather than over a single year. GFOA also states that, although it would be ideal to replace the independent auditor at the end of each audit agreement, the lack of competition among audit firms fully qualified to perform public-sector audits could make a policy of mandatory auditor rotation counterproductive. Instead, 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 been satisfactory.

On February 28, 2013, the City issued a request for proposal to 11 accounting firms and the State Auditor's Office. The request for proposal was for the fiscal year ending June 30, 2013, with an option to extend the agreement for each of the four subsequent fiscal years. A pre-proposal conference was held on March 8, 2013, to answer questions from interested parties. Representatives from nine accounting firms attended in person or via conference call. Responses to all questions from the pre-proposal conference, along with additional questions asked subsequent to the conference, were sent out on March 12, 2013 to all who submitted a Notification of Interest form.

The City received six proposals by the March 15, 2013 due date. The proposals were evaluated by the Director of Finance, Assistant Director of Finance and two Accountants. The evaluation team members independently evaluated and scored all six proposals.

Each firm first had to meet four mandatory elements: 1) the firm is independent and licensed to practice in Iowa; 2) the firm has no conflict of interest with the City; 3) the firm adhered to the instructions for preparation of the proposal; and 4) the firm submits a copy of its last external quality control review report and the firm has a record of quality audit work. All of the firms met these mandatory requirements and were then evaluated for technical qualifications, which made up 75% of the total score.

The technical qualifications were divided into expertise and experience (55%) and audit approach (20%). Included in expertise and experience were past experience with comparable governments (20%), quality of personnel assigned to the engagement (15%), past experience with engagements that submit their comprehensive annual financial report (CAFR) to GFOA for the Certificate of Achievement for Excellence in Financial Reporting (10%), and Single Audit (audit of federal funds) experience with similar federal or state financial assistance programs (10%). Elements of audit approach that were used to evaluate accounting firms were adequacy of proposed staffing plan for segments of the engagement (5%), adequacy of sampling techniques (5%), adequacy of analytical procedures (5%), and adequacy of approach to internal control understanding (5%).

After the technical qualifications were evaluated and scored, the sealed cost proposals were opened and scored. The lowest fee proposal received the highest score, the second lowest fee proposal received the next highest score, and so on.

The following table shows the scores, ranks, and total five-year fee proposals for the six proposals received. The maximum score is 100.

Accounting Firm	Total Score	Rank	Fee Proposal
Eide Bailly LLP	91	1	273,500
McGladrey LLP	86	2	273,160
CliftonLarsonAllen LLP	84	3	262,500
BKD, LLP	79	4	292,000
Bohnsack & Frommelt LLP	62	5	339,400
Denman & Company, LLP	60	6	293,900

The evaluation team agreed that Eide Bailly LLP is the strongest firm. Specific reasons are listed below:

1. The office of Eide Bailly LLP that will be responsible for the City's audit (Dubuque), currently performs audits of 14 local governments in Iowa. Of those, 12 are subject to a Single Audit and eight receive the GFOA Certificate of Achievement for Excellence in Financial Reporting. Firm-wide, Eide Bailly LLP has approximately 100 full-time professionals who devote their time to governmental engagements and share knowledge across the firm.
2. As stated above, Eide Bailly LLP currently audits eight Iowa cities that receive the GFOA Certificate of Achievement for Excellence in Financial Reporting. In addition, three of the four personnel that would be assigned to the City's audit are a member of the GFOA Special Review Committee, which is a group of individuals with public sector experience who evaluate CAFRs submitted for the GFOA's Certificate of Achievement for Excellence in Financial Reporting.

- The fees proposed by Eide Bailly LLP are broken down by fiscal year as follows:

Fiscal Year Ending	Fee Proposal
June 30, 2013	\$ 51,500
June 30, 2014	53,065
June 30, 2015	54,655
June 30, 2016	56,295
June 30, 2017	57,985
Total	\$ 273,500

Total fees paid to Eide Bailly LLP for the last five fiscal year audits are as follows:

Fiscal Year Ending	Fee Proposal
June 30, 2008	\$ 54,250
June 30, 2009	56,650
June 30, 2010	65,350
June 30, 2011	68,800
June 30, 2012	63,000
Total	\$ 308,050

As can be seen in the above tables, the fees proposed by Eide Bailly LLP are very competitive. The fee proposal for the next five fiscal years is \$34,550 less than actual fees paid for the last five fiscal years. The fiscal year 2013/14 Budget includes \$66,150 for the 2012/13 audit. As another point of reference, the City paid \$57,300 in audit fees for fiscal year 1999. Several changes in the work done by City staff prior to and during the audit and greater use of electronic financial data have improved audit efficiency and helped to contain audit costs.

- City personnel have been very satisfied with the work Eide Bailly LLP has done for the City for the past ten years. Eide Bailly LLP staff is very knowledgeable, easy to work with, and meets agreed-upon deadlines. The staff retention rate at Eide Bailly LLP is very high in relation to other public accounting firms, resulting in continuity of staff assigned to the audit. This is important for efficiency of the audit.

The evaluation team feels that there are two firms that stand out from the others, Eide Bailly LLP and McGladrey LLP. The fee difference between the two firms is a mere \$340 over a five-year period. There were a few factors that led to the higher score of Eide Bailly LLP.

- Eide Bailly stresses partner and manager involvement with an estimated 60 hours spent on the engagement by partners and 105 hours by managers. McGladrey LLP only estimates 30 hours by partners and 55 hours by managers. **The concern with this is that there is not enough review by partners to ensure the financial statements are fairly stated and conform to GFOA standards.**

2. McGladrey LLP did not estimate any more hours in the first year of the engagement than they did for the four subsequent years. **This is of concern because auditors typically need to spend extra time during the first year getting to know the operations of the City.**
3. Based on the proposals, Eide Bailly LLP's proposed engagement team directly works on comparable cities within the state of Iowa. **The proposed McGladrey LLP engagement team does not appear to have the same amount of experience working on comparable cities in Iowa.**

Beginning with the request for proposal for the fiscal year ended 2003, the incumbent audit firm was not invited to submit a proposal. For the current request for proposal, the incumbent firm was invited in conformance with GFOA-recommended best practices for soliciting audit services. The staff analysis rated Eide Bailly LLP, the incumbent, as the best overall proposer.

City staff also considered the issue of auditor rotation since there has been much discussion over the past several years among accounting and investment professionals on the value of auditor rotation, especially for audits of publicly-traded companies. The Sarbanes-Oxley Act of 2002 (SOX) required that the U.S. General Accounting Office (GAO) conduct a study of the potential effects of mandatory auditor rotation for publicly-traded companies. The GAO concluded that mandatory auditor rotation may not be the most efficient way to strengthen auditor independence and improve audit quality. Thus, auditor rotation is not required.

SOX also placed a greater emphasis on auditor independence and possible conflicts related to fees collected by audit firms for consulting work. All firms that have submitted proposals are independent. Eide Bailly LLP does no other consulting work for the City. McGladrey LLP has done information-technology consulting, primarily related to network storage, with a \$98,720 contract in 2010 and a contract on March 8, 2013 for \$105,753. City staff does not feel that these contracts impact auditor independence.

Though there may be some value to auditor rotation, there is no data indicating that the value of rotating auditors would exceed the value of selecting the highest-rated firm.

ALTERNATIVES:

1. Approve an agreement with Eide Bailly LLP to audit the City's financial statements for the fiscal year ending June 30, 2013, with the option of auditing the financial statements for each of the four subsequent fiscal years.
2. Direct staff to enter into an agreement with another firm that submitted a proposal for auditing services.
3. Reject all proposals and refer this subject back to staff.

MANAGER'S RECOMMENDED ACTION:

City staff has performed a thorough evaluation of qualified accounting firms to provide auditing services for the City. Eide Bailly LLP is highly qualified in auditing comparable cities in Iowa and has proposed a favorable quote. Staff has been very pleased with the performance of Eide Bailly LLP and believes they will continue to perform to meet the standards of the City.

Therefore, it is the recommendation of the City Manager that the City Council adopt Alternative #1, thereby approving an agreement with Eide Bailly LLP to audit the City's financial statements for the fiscal year ending June 30, 2013, with the option of auditing the financial statements for each of the four subsequent fiscal years.