ITEM #56

ADDITIONAL MATERIAL

REGULAR MEETING

OCTOBER 5, 2021

SUBMITTED AT THE REQUEST OF

OFFICE OF THE COUNTY AUDITOR

OFFICE OF THE COUNTY AUDITOR
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Advisory No. 218

Date: October 2, 2021

To: Honorable Mayor and Board of County Commissioners

From: Robert Melton, County Auditor

Subject: Rotation of Audit Firm – Agenda Item No. 56

The purpose of this memo is to provide background and recommendations regarding mandatory rotation of the external audit firm. Broward County Administrative Code Section 18.61 states "The engagement of an auditor shall be for a five (5) year term with a mandatory change of auditors after five (5) years." The Administrative Code does not require that the mandatory change of auditors also apply to subcontractors. The merits of audit firm rotation have been the subject of significant debate.

Recommendation

We recommend that the Board take no action to change its current policy providing for the mandatory change of audit firms after five years at this time. The current policy has served the County and its taxpayers well. However, should the Board decide to change the policy, we recommend the Board consider the following options which would still provide some benefits of rotation:

1. Allow the incumbent to propose, but only consider their proposal if there are less than three responsible and responsive proposals (with a corresponding change in the County Policies as needed).

2. Preference for rotation every five years, with allowing the incumbent to propose, but adjusting proposal evaluation scores to give preference to non-incumbent firms (similar to the process used by Orange County).

3. Mandatory rotation every ten years, with maintenance of a new RFP process every 5 years.

4. Change the mandatory rotation of firm policy to only require rotation of all partners and managers assigned to the project.

Basis for Recommendation

There is no compelling reason that a change in policy is needed at this time. It has been a basic tenant of the Board that established policies should be followed unless a compelling reason exists to waive or change such policies. At this point in time, the current policy has served the County well since its adoption. Changes to eliminate audit firm rotation are frequently lobbied by incumbent CPA firms in order to maintain the contract for an additional five years. However, the current requirements provide maximum independence for maximum assurance for Broward County taxpayers. While some have expressed concerns that there may only be a limited number of qualified firms capable of performing the County's audit, these concerns have not been substantiated by the competitive solicitations for other similarly sized Florida counties. As summarized in Table 1, the most recent solicitations for similarly sized Florida counties resulted in three or more qualified firms.

Table 1

Summary of number of qualified respondents to the most recent solicitation for external audit service by similarly sized Florida counties:

County	# of firms responding	Last Award Year
Miami-Dade	Nine[1]	2016
Palm Beach	Four[2]	2020
Broward	Four	2017
Orange	Five[2, 3]	2021

[1] Including three incumbents. One solicitation was issued, and four contracts were awarded.
[2] Including one incumbent.
[3] Including one firm deemed non-responsive for adding a contingency making their offer revocable.

As shown in the above table, during Broward County's last solicitation, four qualified CPA firms responded to the solicitation (not including the incumbent who was not allowed to propose). We would consider the receipt of at least three proposals to be fair and open competition.

The current rotation policy provides the best assurance of auditor independence for Broward residents and taxpayers. With no mandatory rotation, the incumbent CPA firm may have less incentive to independently report issues, as they may not want to have conflict with county management. In addition, familiarity develops, and audit firms may become comfortable following previous years' work with minimal effort to identify other potential issues.

The County's current policy is considered a best practice by the Government Finance Officers Association (GFOA). The GFOA acknowledges that the frequent lack of competition among audit firms qualified to perform public-sector audits could make the policy of mandatory audit firm rotation counterproductive. In such cases, the GFOA recommends including the incumbent audit firm in the new solicitation process.

Specifically, GFOA Audit Procurement Best Practices, approved March 8, 2019, states “While there is some belief that auditor independence is enhanced by a policy requiring that the independent audit firm be replaced at the end of each multiyear agreement, unfortunately, the frequent lack of competition among audit firms fully qualified to perform public-sector audits could make a policy of mandatory audit firm 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. Where audit firm rotation does not result from this process, governments may consider requesting that senior engagement staff, such as engagement partners and senior managers, be rotated to provide a fresh perspective.” Since it is not anticipated that there will be a lack of competition in Broward County, the GFOA’s policy would not consider mandatory rotation to be counterproductive.

BACKGROUND

The following information is provided to assist the Board in its consideration of County policy requiring mandatory audit firm rotation every five years.

The merits of audit firm rotation have been the subject of significant debate. Proponents of firm rotation, typically regulatory and watchdog entities, cite the number of audit failures and perceived management influence over auditors as eroding public confidence in audits. Opponents, typically audit firms, accountants, chief financial officers, and corporate audit committees argue that firm rotation results in substantial additional cost.

In 2011, the Public Company Accounting Oversight Board began an initiative to change the SEC policy to require audit firm rotation but encountered fierce resistance and finally abandoned the effort in 2014. As stated above, audit firm rotation is the recommended best practice for governmental entities by the GFOA (assuming there is adequate competition).

Common arguments for and against Audit Firm Rotation are summarized in Table 2.

Table 2

Summary of arguments for and against Audit Firm Rotation

Arguments for Audit Firm Rotation	Arguments against Audit Firm Rotation
➢ **The frequency of audit failures and erosion of public confidence in audits** ➢ **Pressures faced by the incumbent auditor to retain the audit client coupled with the auditor's comfort level with management developed over time can adversely affect the auditor's actions to appropriately deal with financial reporting issues that materially affect the financial statements.** ➢ **New auditors provide a "fresh look" at the client's financial statements and practices.** ➢ **The value of the "fresh look" to protect creditors and other parties who rely on the financial statements outweigh the added costs associated with mandatory firm rotation.**	➢ The new auditor's lack of knowledge of the company's operations, information systems that support the financial statements, and financial reporting practices and the time needed to acquire that knowledge increase the risk of an auditor not detecting financial reporting issues that could materially affect the financial statements in the initial years of the new auditor's tenure. In our view, this situation can be significantly mitigated by selecting a well-qualified governmental audit firm ➢ There is an increase in costs incurred by both the auditor and auditee. Again, this situation can be significantly mitigated by selecting a well-qualified governmental audit firm ➢ The increased risk of an audit failure and the added costs of audit firm rotation may outweigh the value of a periodic "fresh look" by a new auditor. ➢ Audit Partner/staff rotation accomplishes some of the benefits of mandatory audit firm rotation in a more cost-effective manner.

Table 3, on the following page shows rotation policy survey results for similarly sized counties. Broward County requires a mandatory change of auditors after five (5) years. Orange County has a preferred rotation policy with such preference incorporated into the evaluation criteria used in the ranking of firms. Palm Beach and Miami-Dade Counties have no rotation policy.

Table 3

Survey of Rotation Policies

County	Rotation Policy
Miami-Dade	No rotation policy
Palm Beach	No rotation policy
Orange	Preferred - Considered in the evaluation criteria. "…rotation of the auditor or auditing firm will be considered and preferred after a firm serves as auditor for more than two successive contract periods, with each contract period consisting of a one-year contract with four annual renewal options (maximum of 10 consecutive years for the two successive contract periods)."
Broward	Mandatory - "The engagement of an auditor shall be for a five (5) year term with a mandatory change of auditors after five (5) years."

Discussion of Alternatives to the Current Mandatory Rotation Policy

Alternatives exist that would provide some of the benefits of the current mandatory rotation policy while relaxing the current policy. They are:

Option 1

Allow the incumbent to propose, but only consider their proposal if there are less than three responsible and responsive proposals (with a corresponding change in the County Policies as needed).

This option allows for full firm rotation if adequate competition is achieved. This alleviates one of the primary arguments against mandatory rotation—the possible lack of enough CPA firms to provide adequate competition. This provides the full benefit of mandatory rotation if market conditions allow. If not, provision is made to allow the incumbent to compete for the contract.

Option 2

Preference for rotation every five years, with allowing the incumbent to propose, but adjusting proposal evaluation scores to give preference to non-incumbent firms (similar to the process used by Orange County).

This policy clearly establishes a preference for rotation but allows the incumbent to propose. The established preference in terms of points received in the evaluation process provides that a nonincumbent will receive the award if the proposals are otherwise ranked relatively closely. This will help protect the County from selecting an audit firm whose qualification and experience are significantly inferior to an incumbent firm. Also, the preference would help offset the undue benefit the incumbent firm would have from the knowledge gained by being the incumbent.

Option 3

Mandatory rotation every ten years, with maintenance of a new RFP process every 5 years.

This option maintains a mandatory rotation policy, but it lengthens the rotation to 10 years. This serves to reduce any disruption of auditee staff because of a change of audit firms. It also may reduce cost if the same audit firm is used for 10 years. It should be noted that this option could be enacted along with Option 2.

Option 4

Change the mandatory rotation of firms policy to only require rotation of all partners and managers assigned to the project.

This option has become a popular alternative to full firm rotation and is commonly used in public companies. It allows "fresh eyes" on the audit through requiring partner and manager rotation. While this provides some benefit, it does not achieve the full independence benefits of full firm rotation since the same firm is involved and since staffing may be the same people as in previous audits.

I hope you find this information helpful. If you have any questions, please feel free to contact me anytime.

cc: Bertha Henry, County Administrator
Andrew Meyers, County Attorney