
APPENDIX E

MISCELLANEOUS

Audit Procurement Guide

This document is included in the audit manual to assist auditors in understanding the audit environment in the State of Tennessee. Local governments are encouraged but not required to use this guide.

AUDIT PROCUREMENT GUIDE



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
Department of Audit



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AUDIT PROCUREMENT GUIDE

1. Introduction

Under existing laws, the Office of the Comptroller of the Treasury of the State of Tennessee is responsible for ensuring that each local government is audited annually. Such audit may be performed under contract with an external audit firm or by the staff of the Comptroller's Office. This audit procurement guide is intended to assist government officials in selecting an auditor and contracting for the performance of such an audit. This is only a guide and may be modified to fit your entity's specific needs. Questions are often raised about this process and what should be included in the audit report. A synopsis of the questions asked most often follows:

2. What are the purposes of the financial and compliance audit?

The primary purpose of the audit is to determine if financial statements are presented fairly and comply with the requirements of state and local laws and regulations. However, the audit has many other benefits:

- The report is available to any citizen interested in the cost of government and how government is funded.
- The audit identifies problems in the local government's financial operation and recommends corrective action.
- The audit enables government officials to assess the local government's financial condition.
- The audit can be used to provide other agencies with information regarding grants.
- The audit can be used by lending institutions to establish the credit worthiness of the local government.
- The audit can be used by the governing body to determine whether the local government has faithfully followed its mandates and policies.
- The audit can serve as a means of preventing and detecting fraud and dishonesty or unintentional misapplication of funds.

3. What information should the audit contain?

There are several financial statements, schedules, and reports that the audit report must contain before approval by the State Comptroller. A qualified auditor will automatically ensure that these items are included in the report.

- A. Introductory Section (table of contents, letter(s) of transmittal, etc.)
- B. Financial Section
 - 1. Independent Auditor's Report on the Financial Statements
 - a. The report should be either (1) unqualified, (2) qualified, (3) disclaimer, or (4) adverse. The report should detail why an unqualified opinion could not be given
 - 2. Management's Discussion and Analysis
 - 3. Financial Statements
 - 4. Notes to the Financial Statements
 - 5. Required Supplementary Information (RSI)
 - 6. Combining Statements
 - 7. Individual Fund Statements
 - 8. Supplemental Schedules (including a Schedule of Expenditures of Federal Awards and State Financial Assistance)
 - 9. Statistical Information
 - 10. Independent Auditor's Report(s) on Internal Control and Compliance
 - 11. The report(s) on internal control and compliance should state that the audit was performed in accordance with *Government Auditing Standards* (generally accepted government auditing standards (GAGAS)) and the provisions of OMB Circular A-133 (as applicable).
 - 12. The report(s) on internal control and compliance should detail any weaknesses noted or make reference to the findings and recommendations section of the audit report. When reporting on instances of noncompliance and internal control weaknesses, the following items should be included:
 - a. The findings.

- b. Recommendations for improvement.
- c. Comments on corrective action planned.
- d. Concurrence or nonconcurrence of appropriate official with the audit finding.
- e. Comments on the disposition of prior year findings.

4. What qualifications should an auditor have?

For the audit to be accepted by state and federal governments, the auditor must be either a certified public accountant licensed to practice in Tennessee, or a member of the audit staff of the Tennessee State Comptroller's Office. Out-of-state firms auditing organizations that are not based in the State of Tennessee must comply with the requirements of the applicable state(s).

The auditor should have adequate training and experience in governmental accounting and be in good standing in the profession. The auditor in charge of the field work should have a practical working knowledge of applicable state and federal laws and regulations. The auditor should be independent under the requirements of the American Institute of Certified Public Accountants (AICPA) and *Government Auditing Standards* in relationship to the engagement. The audit firm should be currently registered with the State Board of Accountancy and should have participated in an external quality control review at least once every three years, conducted by an organization not affiliated with the firm. (A copy of both the most recent external quality control review report and letter of comment should be provided to the local government.) All audit staff assigned to the audit should have the necessary hours of continuing professional education required by *Government Auditing Standards*.

5. How important is cost in making a decision?

Section 12-4-106, *Tennessee Code Annotated*—Contracts for professional services

Contracts by counties, cities, metropolitan governments, towns, utility districts and other municipal and public corporations of the state, for legal services, fiscal agent, financial advisor or advisory services, educational consultant services, and similar services by professional persons or groups of high ethical standards, shall not be based upon competitive bids, but shall be awarded on the basis of recognized competence and integrity. The prohibition against competitive bidding in this section shall not prohibit any entity enumerated from interviewing eligible persons or groups to determine the capabilities of such persons or groups.

6. How is the auditor selected?

The State Attorney General, in an opinion dated March 7, 1985, stated that governmental units are prohibited by statute from awarding [audit] contracts on the basis of competitive bidding. In

a letter to the Comptroller of the Treasury, dated April 23, 1985, the Attorney General clarified this opinion as follows:

Nothing in *Tennessee Code Annotated* Section 12-4-106 prohibits a governmental entity from requesting proposals from accounting firms for the audit function and to consider price as one factor among others in determining what accounting firm to hire. However, it should be made very clear to firms submitting proposals that cost is only one factor and that the contract will not necessarily be awarded to the lowest in cost.

Our office recommends that all organizations use a Request for Proposal (RFP) as a basis for awarding a contract to audit. (See pages 7 -10 for a Proposal format.)

The cost is only one factor to be considered in awarding a contract to audit. Accordingly, such a contract may or may not be awarded to the low bidder.

Some factors to be considered in awarding a contract are (1) extent and quality of the governmental auditing experience of the firm, (2) the experience of those who would be assigned the actual work, (3) the ability of the auditor to meet the work schedule, and (4) the proposed cost.

The evaluation factors enumerated above and expanded on page 17 are some of those recommended for evaluation. The local government's representatives should not feel constrained about limiting the evaluation factors to those listed in the publication, but the factors to be evaluated should be relevant to the audit and to the audit firm's ability to respond.

7. The audit committee

Local governments are encouraged to consider establishing an audit committee. The comptroller may require that an audit committee be established in any local government in this state that:

(1) Is in noncompliance with the accounting and financial reporting standards required by the Governmental Accounting Standards Board (GASB) on or after the prescribed date of June 30, 2008; or

(2) Has recurring findings from the annual audit for three (3) or more consecutive years as determined by the comptroller to be a material weakness in internal control or material noncompliance under government auditing standards.

The governing body of the local government shall create the audit committee. The audit committee members shall be external to management and may be members of the governing body, citizens from within the boundaries of the local government, or a combination of both. Members of the audit committee shall be selected by the legislative body. The audit committee shall establish responsibilities and duties that are stated in a resolution approved by the legislative body. The responsibilities and duties, at a minimum, shall address financial and other reporting practices, internal control, compliance with laws and regulations, and ethics. The

resolution creating the duties and responsibilities of the audit committee shall be submitted to the comptroller prior to approval by the legislative body. The comptroller shall review the proposed resolution and report back to the local government on whether the resolution follows recommended guidelines for an audit committee. The resolution adopted by the legislative body must conform to the report issued by the comptroller.

8. When to contract

So that an auditor may have time to adequately plan and schedule the audit, a local government should award the contract as early in a fiscal year as possible. A good time to start the procurement process is immediately after the annual audit of the prior year is completed and presented to the governing body and the Comptroller of the Treasury. Every effort should be made to award the contract prior to the end of the fiscal year to be audited.

9. The audit contract

An electronic audit contract should be executed and submitted in accordance with provisions detailed in the *Audit Manual*. The contract provides a section that allows the local government or auditor to add special restrictions or requirements. A local government would be well advised to use this section to formalize any verbal agreements made with the auditor. A sample copy of the most current version of the contract can be obtained at the following web address: <http://www.comptroller1.state.tn.us/audit/contract.asp>.

10. What information should the local government have available for the auditor?

Government officials can reduce audit costs significantly by preparing in advance for the audit. Inaccurate and incomplete financial records will cause the auditor to spend many extra hours during the audit examination. The auditor will have no choice but to bill the local government for these hours.

The local government can prepare, in advance, certain information the auditor will need, including:

- A list of uncollected receivables.
- A list of fixed assets acquired during the year.
- A list of principal revenue sources.
- A list of accounts receivable and payable.
- A list of insurance in force.
- Grant applications and regulations (grant contract numbers, federal CFDA numbers).

- Bank accounts
- Investments.

- A list of grantors.

- Bond and note information.

- Minutes of the board meetings.

11. Where can additional information be obtained?

References

State of Tennessee, Department of Audit—*Audit Manual*

American Institute of Certified Public Accountants (AICPA), *Audits of State and Local Governments*.

OMB Circular A-133: *Audits of States, Local Governments, and Non-Profit Organizations*.

Government Finance Officers Association, *An Elected Official's Guide: Audit Committees and An Elected Official's Guide to Auditing*.

Technical Assistance

State of Tennessee, Comptroller of the Treasury, Division of Municipal Audit, (615) 532-4460

State of Tennessee, Comptroller of the Treasury, Division of County Audit, (615) 401-7841.

REQUEST FOR PROPOSAL
Financial and Compliance Audit
_____ (Local government)
_____ (Date)

Purpose

_____ has issued this request for proposals from interested auditors, who are qualified under state law and regulations, for the performance of a financial and compliance audit of _____ in accordance with the requirements of the laws and/or requirements of the State of Tennessee. This audit shall be for the period beginning _____ and ending _____.

Scope

The auditor shall perform a financial and compliance audit of the financial statements of all funds and grant contracts of the local government.

Type of Audit

The auditor shall conduct the audit in accordance with *Government Auditing Standards* and requirements prescribed by the Comptroller of the Treasury, State of Tennessee. If applicable, the audit should be conducted in accordance with the provisions of the Single Audit Act and U.S. Office of Management and Budget (OMB) Circular A-133 and any other applicable federal management circulars.

General Requirements

1. The auditor shall, as part of the written audit report, submit to the organization's governing body a report containing an expression of an opinion that the financial statements are fairly presented, or an opinion qualified as to certain funds or items in the financial statements, a disclaimer of opinion and the reasons therefore, or an adverse opinion, and shall explain in every detail any unusual items or circumstances under which the auditor was unable to reach a conclusion. This report shall state that generally accepted government auditing standards have been followed in the audit.
2. The auditor's opinion shall be expressed on the opinion units identified in the AICPA Audit and Accounting Guide: *Audits of State and Local Governmental*, as well as the additional requirements in the State of Tennessee Department of Audit *Audit Manual*.
3. The auditor shall furnish copies of the report to the governing body. The auditor shall file copies of said report with the Comptroller of the Treasury, and with the appropriate officials of the granting agencies listed below:

4. If a management letter or any other reports or correspondence relating to findings or recommendations are issued in connection with this audit, a copy shall be filed with the Comptroller of the Treasury. Such management letters, reports, or correspondence shall be consistent with the findings published in the audit report (i.e., they shall disclose no material matters not also disclosed in the findings found in the published audit report).
5. The audit shall begin prior to _____, and the reports shall be submitted prior to _____, but in no case shall be filed later than six (6) months after the fiscal year-end.
6. Pertinent data from the working papers shall be available for three years for reference if requested by the local government.
7. Any evidence of fraud, such as defalcation, misappropriation, misfeasance, malfeasance, embezzlement or other illegal acts shall be reported by the auditor, **in writing immediately upon discovery**, to the Comptroller of the Treasury, State of Tennessee, who shall under all circumstances have the authority, at the discretion of the Comptroller, to directly investigate such matters. If the circumstances disclosed by the audit call for a more detailed investigation by the auditor than necessary under ordinary circumstances, the auditor shall inform the organization's governing body in writing of the need for such additional investigation and the additional compensation required therefore. Upon approval by the Comptroller of the Treasury, an amendment to this contract may be made by the organization's governing body and the auditor for such additional investigation.
8. An audit exit conference with those charged with governance will be conducted by the auditor in charge. At this time, the findings and recommendations regarding compliance and internal control shall be discussed. Those charged with governance shall have the opportunity to respond in writing, to the findings. Responses shall be included in the audit report.
9. The records of the local government will not be removed from government offices except with expressed written permission of the local government.
10. The audit firm shall state its willingness to enter into a contract for one year, renewable annually for each of the next two years by the local government.
11. All adjusting entries will be submitted to the local government in writing with sufficient explanation so that they can be easily understood and properly posted to the financial records. Example: listing of invoices charged to accounts payable supporting any adjusting entries.

General Information

The local government shall have closed and balanced all accounts and shall have prepared financial statements for all funds to be examined by the auditor. Page 12 presents an example that should be expanded to provide the auditor with details of the local government's accounting system.

If additional information is required prior to submitting a proposal, inquiries should be directed to _____ at _____, or by telephone at _____.

Proposal Format

The proposal shall be styled at the discretion of the submitter; however, at a minimum it must address these areas:

1. Nature and extent of the firm's governmental auditing experience.
2. A copy of the audit firm's most recent external quality control review report should be provided to the local government.
3. Organization size and structure of the firm.
4. Qualifications of staff to be assigned to the work. Education, position in firm, and years and types of experience will be considered.
5. Availability of the auditor to the local government for specialized consultation and support assistance on sensitive or highly specialized issues.
6. Type and level of training provided to the firm's staff. Assurance that all audit staff assigned to the audit have obtained the necessary hours of continuing professional education required by *Government Auditing Standards*.
7. The audit fee must be quoted either as a fixed amount or rate per hour, with total estimated hours. If the latter method is used, a maximum amount must be stated for budgetary purposes. Also, estimated incidental expenses, such as travel and supplies, will be included.

Submittal Information

Proposals shall be submitted no later than _____, to:

Opening of Proposals

All proposals will be opened at the regular meeting of those charged with governance to be held on _____ or at a later time and date as specified below.

Time: _____

Date: _____

Place: _____

Reservation of Right

The local government reserves the right to reject any or all proposals, to waive technicalities or informalities, and to accept any proposal deemed to be in the best interest of the local government.

Local government's Name

Budget _____

| Accounting System | |
|---|--------|
| Number of funds | |
| Number of component units (governmental, proprietary, trust and agency) | |
| Checking accounts | |
| Number of purchase orders | /year |
| Number of checks written | /year |
| Number of receipts | /year |
| | |
| Payroll | |
| Number of employees | |
| Frequency of payroll | |
| Number of payroll checks | /year |
| | |
| Other Records | |
| | |
| Item | Volume |
| | |
| | |
| | |
| | |

EVALUATION

The following factors should ordinarily be considered during the evaluation:

Technical Factors

1. Does the proposal clearly state an understanding of the work to be performed?

Evaluators should consider:

- appropriateness and adequacy of proposed procedures.
 - reasonableness of time estimates.
 - appropriateness of assigned staff levels.
 - timeliness of expected completion.
2. Technical experience of firm.
 3. Qualifications of staff.
 4. Size and structure of firm.

Cost Factors

Although cost is a significant factor, it should not be the dominant factor. Cost should be given more importance when all the other evaluation criteria are relatively equal.

If there is reason to believe that an unreasonably low proposal has been made, it should be rejected. One method of measuring reasonableness is to divide the proposed cost by a reasonable average hourly rate to show hours of effort that might be expected. (Refer to page 18 for an example of a proposal evaluation method).

EXAMPLE OF A PROPOSAL EVALUATION METHOD

The following is an example of a method of evaluating proposals. The evaluation formula and the values assigned to the criteria given are for illustration only. Local governments should design formulas and criteria that meet its needs.

Total scores will be determined by adding the points received for technical qualifications (maximum of 70 points) to the points received for the cost of the audit (maximum of 30 points). The total score will be determined by the following formula:

$$\frac{\text{Technical score for this firm}}{\text{Highest technical score received}} \times 70 = \text{Technical score}$$
$$\frac{\text{Lowest cost of all bids}}{\text{Costs of bid for this firm}} \times 30 = \text{Cost score}$$

In the event that oral interviews are necessary, additional points will be given on a scale of 0-10. Although the total score will be a significant factor, the local government reserves the right to make the final selection.

The evaluation of technical qualifications will be based on the following criteria:

Mandatory Criteria

Auditors will not be considered unless they meet each of the following criteria:

1. Must be a certified public accountant properly licensed to practice in the State of Tennessee.
2. Must meet the independence standard established by GAO.

Technical Criteria

Auditors who have met each of the above criteria should be evaluated using the following:

| | Point Range |
|--|--------------------|
| 1. Prior experience in auditing local governments. (Consider: size, complexity, etc.) | 0-20 |
| 2. Organization size and structure of firm. | 0-5 |
| 3. Qualification of staff, including consultants, to be assigned to the audit. (Education, position in firm, and years and types of experience will be considered.) (0-25) | |
| (a) Qualifications and audit team makeup | 0-20 |
| (b) Overall supervision to be exercised over audit team by firm's management | 0-5 |
| 4. Firm's understanding of work to be performed. This will be determined by the approach to the audit and the time estimated to perform each section. (0-20) | |
| (a) Audit coverage | 0-15 |
| (b) Realistic time estimates of program section | 0-5 |
| | <hr/> |
| Technical points | 0-70 |
| 5. Cost of the audit. | 0-30 |
| | <hr/> |
| Maximum points | 100 |