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## ADVISORY NOTES

May 2010

### ***Should We Look for a New Auditor? If so, What's the Process?***

#### INTRODUCTION

In the current economic environment, many nonprofit organizations may be considering seeking audit proposals as a means to ensure that it is getting adequate value from its audit firm. This paper provides guidance on:

1. Deciding if an auditor search is warranted
2. The bid process, from drafting an RFP to selecting an auditor
3. If a new firm is chosen, managing the transition process

#### IS AN AUDITOR SEARCH WARRANTED?

Following are key criteria for determining if a search should be initiated:

1. **Level of Satisfaction with Current Auditor.** This is frequently the most compelling factor that triggers a search. If an organization feels that it is not getting adequate value for its audit fees, it naturally will want to see what other firms offer.
2. **Length of Relationship with Current Firm.** An organization may want to consider switching auditors simply because the existing firm has been engaged for a prolonged time period. ***I believe that organizations that conduct an auditor search at least every 5-7 years, regardless of the level of satisfaction with its auditor, are engaging in good business practices.***<sup>1</sup>

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<sup>1</sup> Much has been written about mandating audit firm rotation as a means to ensure auditor independence, and a simple Web search under the terms "Auditor Rotation" will provide many links for further reading. A good article for nonprofit organizations is ***Audit Firm Rotation as Good Governance Practices for Nonprofit Organizations*** at <http://www.understand-accounting.net/AuditFirmRotation.html>, although I caution that this piece, as with much that has been written on the topic, speaks mostly about the potential negative affect on a audit quality due to a stale auditor-client relationship that can develop over a prolonged time period. While these are certainly valid concerns, my advocacy for periodic auditor searches within the context of this paper is based upon the benefits that accrue to an organization by following a disciplined approach of periodically seeking audit bids. Those benefits are discussed on Page 2.

3. **Economics.** A bid process can deliver cost savings, often even if the incumbent auditor is ultimately retained.

These factors may collectively prompt a search. For example, an organization with a long-term auditor relationship may believe that services have slipped while fees continue to rise. However, often conditions are not as clear cut. For example, an organization may have a fairly long-term and satisfactory relationship with its auditor, and while the fees may seem slightly high, it feels they are acceptable. It is in this “gray area” that organizations may struggle with deciding on an auditor search, as most of us are very busy and are just not sure if we want to expend significant time and energy on the process. Organizations that are struggling to prioritize an auditor search amongst other competing projects and tasks should note that ***if executed properly, an auditor search can yield positive outcomes that go well beyond any fee savings, even if the ultimate outcome is retention of the existing auditor.*** Those benefits include:

1. **It requires the organization to precisely define expectations from its auditor.** An effective search process forces an organization to identify and articulate service levels and outcomes it expects from its auditor. By establishing these benchmarks, it positions them to choose the firm that will best meet its performance expectations.
2. **It facilitates careful study of existing accounting processes and controls.** Organizations involved in a bid process must articulate to the competing firms how its accounting processes and controls function. This are very healthy exercises, as they require an organization to revisit, evaluate, and enhance as necessary, its underlying accounting and work processes and controls.

## **USING POLICY TO ENSURE PERIODIC SEARCHES**

An effective tool for ensuring periodic auditor searches is a board-approved policy that requires, among other things, that the organization conduct an active search for a new auditor within a defined time frame. For example, an effective policy could state that an auditor search is preferred after three years of continuous engagement and mandate a search after five years with the same auditor.

## **IDENTIFYING TARGET FIRMS**

Barring unusual circumstances, the existing audit firm should be included even if there is a fair amount of dissatisfaction with that firm, as the bid process may motivate them to commit to delivering better value. I recommend inviting no more than three additional firms. If you do your homework properly, four firms (three new bidders plus the current auditor) should provide a solid pool of candidates.

Following is guidance for deciding which firms to invite:

- 1. Assess the fit of the current firm with your organization.** This will help you develop a profile of the ideal fit between you and your desired audit firm. Is the current auditor too large and complex? That is, does it appear to be servicing larger and more complex clients at higher rates and neglecting your organization because it is “not lucrative enough”? Or, is the reverse true? Have you outgrown your auditor and do you need a higher level of services?
- 2. Develop an extensive list of possible candidates and do research.** Check around with other organizations that are served by these firms. If you do not know who services other nonprofit organizations and you do not feel comfortable calling its executive director or CFO, *GuideStar* and the organizations’ Web sites can often provide the means to identify their auditors.
- 3. Assess the market; are there firms that appear hungry to expand business?** As you gather intelligence, you may develop a sense that one or more firms is looking to penetrate your market or grow its existing market share in your region. Presuming that a hungry firm also appears to be a reasonable fit, consider inviting the firm to bid, as their market strategy may result in a lucrative fee quote.

## DRAFTING AN EFFECTIVE RFP

The RFP process – from its drafting through to the evaluation of all responses – will most likely be very time consuming. It is crucial that the RFP document seek all relevant information, *but only relevant information*. That is, it should be comprehensive but as concise as possible. *Appendix A* contains a sample RFP. It incorporates selected passages from the American Institute of CPAs’ *Sample Request for Proposal Letter for CPA Services*, which can be viewed at:

[www.aicpa.org/audcommctr/toolkitsnpo/SampleRFP\\_for\\_CPA\\_Services.htm](http://www.aicpa.org/audcommctr/toolkitsnpo/SampleRFP_for_CPA_Services.htm)

These templates are intended to provide general guidance on drafting an RFP. Each organization’s needs, priorities, and circumstances are unique; therefore be sure to construct your document so that it will provide feedback that best meets your needs. ***The RFP should include explicit language stating that you prefer a minimum three-year quote; as such a requirement will prohibit firms from low-balling its price in the short-term as a means to capture business.***

## EVALUATING PROPOSALS

Following is guidance on what to look and listen for in responses to selected questions. ***This is not to suggest that these questions are more important than others.*** Instead, this advice is included because these questions are open-ended (as opposed to questions that ask for factual data such as names of key audit staff and fee quotes).

- **Candidate firm’s core competencies and how it believes it adds unique value (Template Question # 6).** Look carefully for compelling responses. For example, did the firm provide illustrative anecdotes to explain how it proactively helped a client address an emerging issue? Do their responses demonstrate that they think beyond the role of an auditor and look to provide creative and valuable consultative advice?
- **Description of firm’s audit approach (Template Question # 7).** What does the candidate firm offer that appears to represent improvements in the efficiency and effectiveness of the audit? Conversely, what stated methods cause you concern based upon past positive audit experiences?
- **Firm’s approach for handling periodic questions during the year (Template Question 9).** The purpose of this question is to understand the firm’s philosophy and practices for billing (or not billing) for routine accounting-, reporting-, and tax-related questions. Listen for language indicating that the firm welcomes dialogue throughout the fiscal year (and does not bill for such conversations), as proactive discussion can lead to fewer problems during the audit.
- **How the firm educates and informs clients on emerging accounting and reporting issues (Template Question 8).** This question can provide great insight on the firm’s ability to deliver value. For example, with a recent accounting pronouncement, what did it do to proactively help clients understand the pronouncement, thus helping to ensure that transactions were recorded correctly?

Once all proposals have been received, the search coordinator should, to the extent possible, summarize all responses in a matrix that enables reviewers to perform side-by-side comparisons. Furthermore, in addition to careful study of all written responses and verbal responses provided in an interview setting, ***I suggest that the organization pose the questions noted above to other organizations serviced by the candidate firm during reference checks.***

## **CLEAR CONCISE COMMUNICATION IS CRUCIAL**

Note the following passage towards the end of the RFP document:

***The ability of your firm to communicate in a clear, comprehensive, and concise fashion will be seriously considered in our review, as we believe that the capability to do so is indicative of the overall quality of the services that your firm can provide.***

Because the search process will probably burden the organization with a stack of proposals, a firm that communicates its case in a very efficient and effective fashion—both in writing and verbally (see “Interviews” below)—demonstrates a strong business competency that should translate to delivering superior value.

## REDUCING THE FIELD

Once all proposals have been evaluated, the organization may want to eliminate one or more firms from further consideration before conducting on-site interviews. ***Ultimately you will not want to eliminate from further consideration any firm that you think has a reasonable chance of being chosen.***

## INTERVIEWS

The most crucial part of the selection process is the on-site interviews, especially if the evaluation of written proposals shows no clear-cut favorite. Ultimately, the chosen firm will be the one that appears to fit best with the organization, provided of course that a good fit also comes with a reasonable fee! Following are some suggested strategies for evaluating candidates' interview performances.

1. **Assess strength of firm's overall resources and competencies.** Naturally, the main focus will be on audit services, but try and also assess the strength of the firms' tax, IT, and other resources.
2. **If possible, identify a complex accounting concept or issue that is relevant to your organization and ask them to respond with their thoughts and recommendations.** Ask probing questions in order to gauge their technical competencies.
3. **Look for good, creative, and original answers.** As with written responses, award points for clear, concise, and intelligent answers.
4. **Focus on the manager and/or in-charge.** More than anything else, a successful audit will most likely hinge upon the competencies and even personality of the on-site engagement leader. Make sure this person is engaged in the interview, and if not, ask probing questions of him/her in order to assess his/her competencies and fit with the finance staff.

## MAKING YOUR SELECTION

Selecting an auditor is both quantitative and qualitative exercise, and if you have done your work throughout the process, you will make a good choice. It may not be an easy choice, but it will be a good one.

## THE TRANSITION PROCESS

Assuming that a new auditor is chosen, the final step is the transition process. This phase, if managed correctly, will provide a solid foundation for a successful audit. The new auditor will want to be very proactive in planning the transition, and you will want to work very closely with the firm through this

phase. The best transitions are those where there is solid two-way communication and coordination between the new auditor and the client.

**Perhaps the most important point to make is that an effective transition takes a lot of work from BOTH sides.** The new auditor is naturally going to be asking for a lot of foundational information that goes well beyond core historical accounting analyses and schedules—such as requesting a myriad of institutional policies and procedures, organization charts, board and committee meeting minutes, etc. **But perhaps most crucial of all, they will be looking for good answers and clear direction from staff.** Don't shirk these responsibilities, for if you put forth the effort on the front end, the audit should go relatively well.

### **AN AUDITOR'S POINT-OF-VIEW**

While composing this paper I asked a member of a regional accounting firm to read it and give me his perspective. Following are selected points he provided.

- 1. Staffs need to dedicate more time on the bid and transition process.** "Drafting and sending out the RFP document is simply the first step in a very time-consuming process. Many organizations fail to put forth the required effort and due diligence that are necessary to make a good, informed decision. And, once a decision has been made, organizations too often look to the transition as "the auditor's job". Thus, they fail to invest the necessary time and effort to ensure that the year-end audit goes well."
- 2. Organizations are asking for greater information in RFPs, but not digging deep enough to assess candidates' qualifications.** "I recently proposed on an engagement where we served almost four times as many clients in this sector than the finalist competitor and was told by the organization that they perceived both finalists to have adequate industry knowledge and experience. Based upon their response, I could only conclude that they failed to adequately review the proposals"

These statements affirm my belief that an auditor selection process requires much effort. And rightly so, for it is an important decision and one that you'll most likely get from it what you put into it.

### **CONCLUSION**

Organizations that properly conduct periodic auditor searches in a disciplined fashion will invariably realize benefits that go well beyond the potential economic windfall of holding audit fees in check. However much skill and effort is needed to achieve these outcomes, and as such, organizations must commit themselves to effectively managing the entire process, from the RFP design all the way to the new auditor transition.

## **ABOUT THE AUTHOR**

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**APPENDIX A**  
Sample Audit RFP

(Letterhead)

\_\_\_\_\_, 201#

Candidate Firm Principal's Name

Firm Name

Firm Address

\_\_\_\_\_, PA \_\_\_\_ - \_\_\_\_

Dear \_\_\_\_\_:

**Request for Proposal for Audit and Tax Services**

(Nonprofit organization's name) wishes to receive proposals from area CPA firms to provide audit and tax services for the fiscal years ended \_\_\_\_\_ ##, 201#, 201#, and 201# and invites (invited firm's name) to submit a proposal for our consideration by no later than \_\_\_\_\_, 201#. A description of our organization, the requested services, and other relevant information follows.

**Background of (nonprofit organization's name)**

(Organization's name) is a 501(c)(3) organization that provides (insert brief description of organization's services/mission). Total revenues for the fiscal year ended \_\_\_\_\_ ##, 20## were \$ \_\_\_\_\_. The organization has \_\_\_ full-time employees and \_\_\_ part-time employees in one location. (Nonprofit organization's name) currently has approximately \_\_\_ annual contributors. INSERT ANY OTHER RELEVANT DESCRIPTIVE INFORMATION HERE. For more information on our organization, please visit our website at www.\_\_\_\_\_.org.

**Requested Services**

1. Annual audit of (nonprofit organization's name)'s financial statements in accordance with Generally Accepted Auditing Standards.

2. Annual federal grants audit , in accordance with requirements of OMB Circular A-133
3. Preparation of (or review of self-prepared) Form 990 and 990T.
4. Presentation of the audit report to (nonprofit organization's name)'s audit committee.

**Key Dates**

Proposal submission due \_\_\_\_\_, 201#  
 Selection of auditor \_\_\_\_\_, 201#  
 Audit report due \_\_\_\_\_, 201#  
 Audit Committee presentation \_\_\_\_\_, 201#  
 Form 990 and 990T Tax completed \_\_\_\_\_, 201#  
 Federal grant audit report completed \_\_\_\_\_, 201#

**Requested Proposal Information**

In responding to this request, we request the following information:

1. A description of your firm’s experience in providing auditing and tax services to nonprofit organizations of comparable size and complexity.
2. The names of all persons expected to have with key responsibilities for the engagement, with accompanying biographies and qualifications. Please disclose any corrective actions that have been taken by your firm with respect to these people.
3. Discuss commitments you will make to staff continuity, including your staff turnover experience in the last three years.
4. The names and contact information for other similar-sized nonprofit clients that have been serviced by the key parties to be assigned to the engagement so that (Nonprofit organization’s name) can contact these persons for reference purposes.
5. Identify the five largest clients your firm (or office) has lost in the past three years and the reasons. Also discuss, in instances where loss of the client was due to an unresolved auditing or accounting matter, the process of attempting to resolve the issue(s).
6. A description of your firm’s core competencies and an accompanying statement of why you believe that your firm’s services can add unique value.
7. A description of your firm’s audit approach, including an identification of areas that will receive primary focus. Also, please discuss the communication process used by the firm to discuss issues with the management and audit committees of the board.
8. Proposed fees for each of the three year’s services, quoted either as a fixed amount or rate per hour, with total estimated hours. If the latter method is used, please include a maximum (i.e., “not-to-exceed”) amount. Please be sure to clearly disclose if estimated incidental expenses such as travel and supplies will be included in your base fee, or if such costs will be billed in addition to the quoted base fee.
9. An explanation of how your firm intends to charge for accounting- and tax-related questions that we may have from time-to-time throughout the year.

10. An explanation of how your firm educates and informs clients on emerging accounting and disclosure issues.
11. A fee schedule that shows the FY2010, 2011, and 2012 fees broken segmented by:
  - a. Financial statement audit
  - b. Federal grants audit
  - c. Form 990 and 990T services
12. Standard billing rates for all classes of professional personnel for each of the last three years.
13. Your firm's most recent peer review report, the related letter of comments, and the firm's response to the letter of comments.

### Key Contacts

The following are key contacts for information you may seek in preparing your proposal:

Name 1	Title	Email address	Phone #
Name 2	Title	Email address	Phone #

### Evaluation of Proposals

(Nonprofit organization's name) will evaluate proposals on an overall cost-vs.-benefits basis. That is, the engagement will not necessarily be awarded to the lowest cost bidder. Our evaluation process will include, but not be limited to, a review of your firm's peer review report and related materials, interviews with senior engagement personnel that would be assigned to the engagement, results of discussions with other clients, and the quality of the firm's response to our inquiries.

Our review will rely heavily on both the content and quality of all written and verbal communication throughout the evaluation process. ***The ability of your firm to communicate in a clear, comprehensive, and concise fashion will be seriously considered in our review, as we believe that the capability to do so is indicative quality of the services that your firm seeks to provide.***

### Submission of RFP Responses

Proposals submitted in response to this Request for Proposal (RFP) must be received no later than 5:00 P.M. on \_\_\_\_\_, 201#. Proposals should be sent to:

Name of Primary Contact  
Title  
Street Address  
City, PA Zip

Please send    **copies** of the entire proposal in a sealed envelope clearly marked **Audit Services Request for Proposal**. We would also appreciate being notified if you decline to submit a proposal.

Sincerely,

Name of Primary Contact

Title

Attachments:

Most recent internal financial statements

June 30, 2009 Audit Report, with Management Letter Comments

June 30, 2009 Form 990 and 990-T