

**Office of the President**

**TO MEMBERS OF THE COMMITTEE ON COMPLIANCE AND AUDIT:**

**ACTION ITEM**

*For Meeting of September 18, 2013*

**APPOINTMENT OF THE REGENTS' EXTERNAL AUDITOR**

**EXECUTIVE SUMMARY**

After considering the recommendation of management, the Committee on Compliance and Audit is responsible for recommending to the Regents the independent certified public accountants to be appointed to serve as external auditor. On March 15, 2011, the Committee on Compliance and Audit approved the extension of the contract with the current external auditor, PricewaterhouseCoopers (PwC), for an additional two-year period, commencing with the annual audit for fiscal year 2012. The existing contract with PwC will expire upon completion of the 2013 fiscal year audit. To meet external reporting timelines, it is important that the auditor be appointed early in fiscal year 2014.

Management conducted a competitive bidding process for certified public accounting firms to serve as the external auditor for the University. Based upon evaluation of the qualifications and the fees, management recommends the selection of KPMG as the external auditor for the University for five years commencing with the fiscal year ending June 30, 2014.

**RECOMMENDATION**

The President recommends that the Committee on Compliance and Audit recommend to the Regents that KPMG be approved as the Regents' external auditor for five years, commencing with the audit for the year ending June 30, 2014.

**BACKGROUND**

At the January 15, 2013 Committee on Compliance and Audit meeting, Chief Financial Officer Taylor presented management's plan for the external audit request for proposals (RFP) from all qualified independent accounting firms for conducting the annual examination of the financial statements of the University. The RFP covered the selection of an external audit firm for a five-year period beginning with the audit for the fiscal year ending June 30, 2014.

Chief Financial Officer Taylor was the Project Sponsor for the RFP and a Selection Committee was formed, consisting of 28 cross-functional representatives from the campuses,

medical centers, campus foundations and the Office of the President, spanning finance, accounting, treasury, and information technology areas. All significant systemwide audit areas were represented on the Selection Committee. In addition, the outside financial advisor to the Committee on Compliance and Audit, Alan Edrick, attended the oral presentations made by the bidders.

### **Role of the Selection Committee and the Project Sponsor**

The role of the Selection Committee was to:

- Develop the request for proposal (RFP),
- Work with UCOP's Procurement Services through the bid process,
- Develop the evaluation criteria,
- Evaluate firms against the established criteria, and
- Make a recommendation to the Project Sponsor.

The role of the Project Sponsor was to make a recommendation to the Committee on Compliance and Audit of the firm that should be engaged to perform external audit services.

### **Proposal Process**

The external audit RFP was publicly posted on the UCOP Procurement Services Systemwide RFP opportunities website. Five firms responded to the RFP with an initial "Intent to Bid"; PricewaterhouseCoopers (PwC), KPMG, Moss Adams, Grant Thornton, and BDO. During the process, Grant Thornton and BDO withdrew from the RFP process.

A bid conference was held in March at the Office of the President for the purpose of providing any additional information and responding to questions regarding the proposal process.

Site visits were conducted at each campus, medical center, and at the Office of the President during the first two weeks of April. Senior management at each campus, medical center and campus foundation had the opportunity to interact with the firms during the site visits. The external audit firms visited as a group in order to ensure that they all received exactly the same information both written and orally. If any firm had questions about the University or the proposal process, that question was answered for all the other firms as well. Following UC's procurement process requires that all firms be on equal footing throughout the process to ensure that it was a fair process for each firm.

Written proposals were received from the three firms on April 26, 2013. The Selection Committee reviewed and evaluated the written proposals and met in late May to discuss its evaluations. The Selection Committee then measured each firm against the established criteria for the written proposals. As a result of the rankings, the Selection Committee identified two firms that were qualified to meet the University's external audit requirements.

In late June, oral presentations were conducted; and the two firms made presentations and answered questions from the Selection Committee. The process provided ample opportunity for discussion and an exchange of information between the firms and the Selection Committee. The Selection Committee evaluated the oral presentations.

**Evaluation Criteria of Written and Oral Presentations**

Both the written and oral presentations were evaluated by the Selection Committee, using all criteria except fees, to determine a single overall qualitative rating. The Selection Committee developed separate criteria for both the written and oral presentations and did not receive proposed fees until the written and oral presentation evaluations were complete. For the written proposals, four strategic areas were critiqued and weighted based on their level of importance as follows (detailed descriptions of the criteria considered for each area are outlined below):

	Area	Weighting
1.	Knowledge and Experience	40%
2.	Approach to Performing the Audit and Other Work Required to Meet Deliverables	30%
3.	Administration Policies and Operating Culture of the Vendor	20%
4.	Executive Summary	10%
		<b>100%</b>

**Knowledge and Experience**

1. Description of the firm’s experience in higher education with large research institutions, academic medical centers within a higher education setting, employee benefit plans, not-for-profit campus foundations under the GASB framework, federal program expenditure audits, National Laboratories, investments in a GASB framework, and NCAA reporting.
2. Description of the team’s experience, including detailed information on key team members including the partner in charge, the reviewing partner, engagement partners, managers and seniors highlighting their experience and skills, including estimates of partner time the firm intends to commit to the contract.
3. References of major client organizations from higher education and health care industries and related contact information (names and telephone numbers).
4. Higher education resources available to assist management and the Regents’ Committee on Compliance and Audit including training courses, industry information, and newsletters.

**Approach to Performing the Audit and Other Work Required to Meet Deliverables**

1. The firm’s audit approach, including its approach for interim and year-end

- fieldwork, and assessing control risk for similar organizations.
2. The firm's approach to auditing large, complex and decentralized IT systems.
  3. Description of how the firm coordinates with and evaluates internal audit departments.
  4. Description of how the firm leverages its client's technology in the audit and how the firm trains staff to use its client's technology.

### **Administration Policies and Operating Culture of the Vendor**

1. Firm's staffing policies, including staffing level ratios and number of managers assigned to clients.
2. Firm's policy on staff and management rotation, a description of how the firm minimizes turnover, and how the firm trains and educates new staff.
3. Description of the firm's plan for internal coordination and communication to assure consistency, quality and timeliness in meeting the University's deadlines.
4. Description of how the firm contains the costs of financial audits for institutions with which the University operates (i.e. higher education, medical centers, campus foundations, and employee benefit plans).

### **Executive Summary**

1. A description highlighting why the firm believes it is the best qualified to conduct the University's audit, including a description of what the firm offers that competing firms cannot.

Oral presentations by the top two firms were evaluated based on their responses to the following questions:

#### **1. Communication and Coordination**

Description of the firm's plan for internal coordination and communication to ensure efficient and effective use of University resources, timeliness of services and meeting deadlines, and a discussion of the firm's plan during the year-end audit and throughout the year.

#### **2. Staffing**

Description of the firm's staffing mix and amount of partner time devoted to the University's audits. Additionally, the Selection Committee wanted to know the other commitments for the partners on the team.

#### **3. Audit Approach**

Description of the firm's expectations of the University to support the audit, the risks identified of the University, and how the firm manages audit approach changes identified mid-audit.

**4. Issue Resolution**

How the firm would manage the impact to the University audit if issues that require consultation with the national office were to occur.

**5. Independence and Confidentiality**

Description of how the firm manages independence of the University's team members and minimizes the risk of non-compliant or unethical behavior and what safeguards are in place to protect the University's confidential information.

**6. Other Services**

Description of how the firm assesses permissibility and manages the process for complying with the University's Policy BFB-BUS-76 for additional services with the Regents' auditor.

Following the oral presentations, the Selection Committee wanted clarification from the firms on some of the comments made during the oral presentations. The firms were requested to respond in writing to additional questions from the Selection Committee.

Additionally, three references for each of the firms were contacted by Procurement Services. Each of the references was asked the same list of questions. The responses from the references were summarized and distributed to the Selection Committee.

Each of the firms was also requested to submit their best and final offer for fees.

**Evaluation Results of Written and Oral Presentations**

The firms were evaluated using the following rating scale:

- Superior
- Exceeds Expectations
- Meets Expectations
- Partially Meets Expectations
- Does Not Meet Expectations

Each member of the Selection Committee individually evaluated the written proposals from each firm based on this scale, consulting with their constituents at their campus, medical center or foundation, as needed. Each member's evaluation was summarized and a composite rating was derived for each firm.

Using the weightings described above in the evaluation criteria section, KPMG and PwC received the highest ratings, with a narrow margin differentiating the two firms. Out of a total weighted average rating of 5.0 possible, KPMG received a total rating of 3.44, PricewaterhouseCoopers received a total rating of 3.42, and Moss Adams received a total weighting of 2.98. The Selection Committee decided that KPMG and PwC had the requisite experience to meet the University's external audit needs, and therefore, KPMG and PwC

were selected by the Committee to make oral presentations.

For the Oral Presentations, each of the six questions was weighted equally and a similar approach was used for evaluating the responses and calculating a composite rating. Out of a total average vote rating of 5.0 possible, KPMG received an overall rating of 3.37 and PwC received an overall rating of 3.31.

As a result of the above analysis, the Steering Committee determined that both KPMG and PwC were equally qualified from a qualitative perspective to meet the University's external audit needs.

### **Annual Fees**

After all the evaluations were completed, summarized, and confirmed with the Selection Committee, details on proposed fees were provided to the Selection Committee. The firms were requested to propose on audits for the University, medical centers, retirement plans and campus foundations. The campus foundations were included in the RFP process and participated on the Selection Committee to achieve cost savings for their external audit services. The proposed fees for five years were \$19,409,000 by KPMG and \$26,053,115 by PwC. For the first year, KPMG's proposed fees were \$945,000 lower than PwC. KPMG offered a significant discount to the University; the hourly rate was lower and lower fee increases were requested for 2015 through 2018. KPMG devoted more partner and manager hours in relation to the total hours on their engagement team. KPMG also committed not to increase fees when the University has to adopt new accounting rules or transitions to new information systems.

### **Overall Rating**

Management recommends that KPMG be engaged as the external auditor for a five year term. While both KPMG and PwC were considered equally qualified to perform the external audit services, the fee proposed by KPMG achieves cost savings, which is in the best interest of the University. Management acknowledged that additional effort will be required in 2014 to transition to a new audit firm; however, there are also benefits to a fresh look by a new firm.