

ALAMEDA-CONTRA COSTA TRANSIT DISTRICT



STAFF REPORT

MEETING DATE: 12/8/2021

Staff Report No. 21-467

TO: AC Transit Board of Directors
FROM: Jill A. Sprague, General Counsel
SUBJECT: Auditor Rotation

BRIEFING ITEM

RECOMMENDED ACTION(S):

Consider receiving a report regarding the legality of precluding an audit firm from competing for a new contract based on the firm's immediate prior role as auditor for the District (Requested by Director Peebles - 8/11/21).

STRATEGIC IMPORTANCE:

There is no strategic importance associated with this report.

BUDGETARY/FISCAL IMPACT:

There is no budgetary or fiscal impact associated with this report.

BACKGROUND/RATIONALE:

California Government Code Section 12410.6(b) requires the rotation of lead audit partners and coordinating audit partners if an audit firm continues to provide audit services to a public agency for greater than six fiscal years. In compliance with this requirement, Board Policies 340 (Accounting Policy) and 465 (Procurement Policy) have each been revised. Reference to Section 12410.6(b) was included in Board Policy 465 in June 2020, while Board Policy 465 section IV.B.1(g) specifies that audit contracts shall be competitively bid at least every five years and that firms must specifically identify how they will address the requirements under Section 12410.6(b) in their Request for Proposal response to the District. In addition, Board Policy 340 requires that the District issue an RFP for audit services every five years. Neither the statute nor Board Policies require that the District use a different audit firm or preclude the incumbent audit firm from submitting a proposal, so long as a new lead audit partner and coordinating audit partner submit the proposal and perform the work.

The Board at various times has inquired whether the District should exclude the entire incumbent audit firm (as opposed to the specific audit partners) from the procurement and selection process. At the Board meeting on August 11, 2021, the General Counsel advised that this is not required by law or Board Policy, and that such an exclusion may violate applicable federal requirements for "full and open competition" in procurements. The General Counsel's advice was questioned, and accordingly, an independent outside legal opinion on this matter was sought.

Legal Opinion

Outside legal counsel, Bruce Smith of Apperson Crump, has opined that, “excluding an otherwise qualified accounting/audit firm from submitting a Proposal is contrary to fundamental principles of full and open competition embodied in the Federal Transit Act, the Federal Transit Administration Third Party Contracting Guidelines (FTA Circular 4220.1F) and other federal rules applicable to the District as a recipient of federal financial assistance.” Counsel specifically cites the Federal Transit Act which requires that “Recipients of assistance under this chapter shall conduct all procurement transactions in a manner that provides full and open competition as determined by the Secretary.” Noting that the California legislature could have required public accounting firms to be rotated after performing audit services for a local agency for six years but has not done so, counsel concludes that “excluding a firm from participating in the procurement process in excess of the California Government Code would constitute an ‘arbitrary action’ in the procurement process.” “Accordingly, prohibiting an entire firm from competing for a contract to provide audit services to a local agency would violate the requirement to provide full and open competition.”

Best Practices

Further, as noted in Mr. Smith’s legal opinion attached, there is no law that requires the rotation of audit firms or the exclusion of a firm from submitting a proposal. An October 7, 2020, article on accountingtoday.com notes that “[t]he Public Company Accounting Oversight Board has come out firmly against proposals for mandatory audit firm rotation in the U.S., especially after the House of Representatives approved a bill in 2013 that would actually ban mandatory firm rotation.” The article goes on to cite two academic studies looking at the two reasons most cited for mandatory auditor rotation - that personal ties develop over time between auditors and clients, and that mandating rotation brings a fresh look to audits and improves the quality of reporting - noting that both studies found “no significant fall-off in reporting quality over the course of partners’ five-year tenures, . . . and little or no evidence that the fresh looks mandated by [Sarbanes-Oxley] make for improved audits.”

It is, however, worth noting that the new partner from the District’s audit firm Crowe (which is in the first year of a second five-year contract with the District) identified one balance sheet account that was in error in the prior year when the audit was under the prior partner. Although not material to the financial statements as a whole, the discovery resulted in staff planning corrective actions for the current and future periods. In other words, the system is working - by requiring rotation of lead audit partners but not necessarily entire firms, a fresh set of eyes can identify errors that may have been previously missed.

ADVANTAGES/DISADVANTAGES:

There are no advantages or disadvantages to receiving this report.

ALTERNATIVES ANALYSIS:

There is no alternative analysis to this report.

PRIOR RELEVANT BOARD ACTION/POLICIES:

Minutes of June 8, 2016 Board Meeting

Staff Report 20-912a Amendments to Board Policy 465
Staff Report 20-109 Amendments to Board Policy 340
Staff Report 21-318 Award of Three-Year Contract to Crowe LLP
Staff Report 21-361 Report on the Rotation of Financial Audit Service Firms

ATTACHMENTS:

1. November 16, 2021 Memorandum from Bruce M. Smith, Esq.
2. Government Code Section 12410.6

Prepared by:

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Approved/Reviewed by:

Chris Andrichak, Chief Financial Officer

Linda A. Nemeroff, District Secretary

Michael A. Hursh, General Manager