

# Hiring a Quality Auditor:

Your Guide to the Selection Process



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# INTRODUCTION

CPAs provide a wide range of services to the public, and auditing is at the core of those services. Since the founding of the American Institute of CPAs (AICPA) in 1887, the Institute and the profession have been committed to achieving the highest level of performance for financial statement audits.

As part of the AICPA's commitment to quality, we are providing this resource to assist your organization in:

- ▶ Understanding the importance of hiring a quality auditor to perform your financial statement audit
- ▶ Evaluating auditor qualifications
- ▶ Implementing the proposal process, including the request for proposal, proposal evaluation and auditor selection
- ▶ Documenting the agreement

## WHY A FINANCIAL STATEMENT AUDIT IS IMPORTANT

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A financial statement audit provides an independent, third-party report to management, shareholders and other interested parties that indicates whether an entity's financial statements provide reliable information.

Organizations need audited financial statements for a variety of reasons, depending on their size, ownership structure, industry, etc. For example, an entity's lending institution may require audited financial statements to extend financing, or shareholders may request audited financial statements if they aren't actively involved in running the company.

There may be additional legal requirements or fiduciary responsibilities particular to your organization that govern the need for an audit. For example, organizations with employee benefit plans may have an obligation to obtain an audit of the plan. Or entities that receive grants may have specific reporting requirements required under the terms of the grants.

The audit also may help management improve and streamline operations by evaluating the strength of internal control over financial reporting and identifying control weaknesses.

Hiring a firm to provide audit services to your organization can be the first step in developing a relationship with trusted professionals who have the training and knowledge to help your organization in many ways.

Audits of employee benefit plans, not-for-profits, governmental entities and publicly traded companies are highly specialized. Refer to the Additional Resources section of this guide for information specific to these types of audit engagements. We may refer to some unique considerations relative to these engagements in this guide, but recommend you obtain additional information if you are considering hiring an auditor for such an engagement.

## EVALUATING AUDITOR QUALIFICATIONS

Reviewing the auditor's qualifications is a critical step in selecting your auditor. This will require the consideration of licensing and independence rules, as well as the auditor's experience and professional development, including specific audit experience in your industry and continuing professional education.

Experience and professional development

Identifying quality audit firms

Independence

Licensing

### Experience and Professional Development

A firm equipped to provide a high-quality audit to your organization should be able to demonstrate its qualifications in response to your request for proposal. Evaluate whether the firm has experienced, qualified staff. Not only is overall experience important, but also experience relevant to your organization (retail, banking, construction, manufacturing, not-for-profit, etc.) is a component of the firm's qualifications.

In some instances, a less experienced auditor may be assigned to perform routine audit procedures in order to reduce audit costs. When this happens, you should confirm that an experienced auditor will review his/her work, as well as perform the more complicated audit procedures.

### Identifying Quality Audit Firms

The size of a firm doesn't dictate the level of audit quality — it's their commitment to quality. The AICPA established the profession's Peer Review Program to enhance the quality of accounting, auditing and attestation services performed by its members in public practice. The results of a firm's peer review provide a look at quality control systems and adherence to the profession's standards. If a firm doesn't provide the results of its latest peer review with its proposal, ask for it. You'll also find information on accessing a firm's peer review information in the Additional Resources section of this guide.

A commitment to quality can also be shown by a firm's additional membership in AICPA resource centers, including the:

- ▶ **Governmental Audit Quality Center (GAQC)** — Includes resources relating to financial statement audits of both governments and not-for-profits and single audits
- ▶ **Employee Benefit Plan Audit Quality Center (EBPAQC)** — Offers tools and resources to promote the quality of employee benefit plan audits
- ▶ **Center for Audit Quality (CAQ)** — Provides resources for auditors of public companies
- ▶ **Private Companies Practice Section** — Includes resources relating to quality control
- ▶ **Center for Plain English Accounting** — Provides technical assistance to CPA firms

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Firms that are members of the GAQC and EBPAQC are required to establish higher standards of audit quality in their policies and procedures specific to the particular practice area. These quality centers also offer additional resources to help firms provide quality services to their clients.

If these practice areas are relevant to your organization, as you consider firm proposals, ask representatives of the firms if they are members of these centers.

When engaging an auditor, you should obtain references and discuss the auditor's work for other clients. You may want to obtain the continuing professional education records of the proposed audit team and determine that team members have recent training that addresses unique issues related to your industry, if applicable.

## **Independence**

CPA professional standards require that the auditor be independent for purposes of auditing financial information and issuing an auditor's report on the financial statements. The auditor's independence is essential for a successful audit because it enables him or her to approach the audit with the necessary professional skepticism. Independent auditors must adhere to rules of auditor independence established by the AICPA (and the SEC and the Public Company Accounting Oversight Board, if applicable).

## **Licensing**

CPA firms are required to meet the licensing requirements of the state(s) in which they practice. You may wish to verify with the appropriate state regulatory authority that the audit firm holds a valid, up-to-date license or certificate to perform auditing services (most states make this information available online).

## THE PROPOSAL PROCESS

The first step in hiring a quality auditor is preparing a comprehensive request for proposal (RFP) that will allow you to obtain the information you need to make a decision about the qualifications of the firms and the value they can bring to your organization.

### Introduction

The introduction section of the RFP should provide a general description of the nature and scope of the engagement to be performed. It should:



### The Request for Proposal (RFP)

The preparation of a sound RFP is an important part of the proposal process. A quality RFP will determine the quality of the respondents and will help reduce the time and effort expended in the overall RFP and selection process. It is critical that you ask informed questions during the proposal process in order to obtain adequate information on which to base your final decision to hire an audit firm. In addition, it is important that you provide audit firms with sufficient information about the nature of the entity and the engagement to allow them to make a meaningful and comprehensive proposal that addresses your specific needs. The RFP should outline the proposal and selection process, as well as summarize the background, objectives, expectations and requirements of the engagement to be undertaken. Therefore, the following should be remembered when preparing the RFP:

- ▶ Communicate the facts and conditions surrounding the engagement to be completed
- ▶ State your objectives and requirements clearly and thoroughly
- ▶ Be specific about the information needed to properly evaluate the proposal
- ▶ Require the proposal to be presented in a common format to allow for efficient and effective evaluation and comparison

- ▶ Describe why the RFP is being released. Discuss in general terms the objective to be achieved and the reason professional CPA services are being sought
- ▶ Discuss the term of the engagement, such as the length of time the contemplated contract covers (for example, an annual or a multi-year engagement), along with renewal options
- ▶ Provide an overview of how the RFP is structured and describe what information or supporting documents are contained in the appendixes, attachments, or the body of the RFP document

The introduction section also should include the following procedural information:

- ▶ Whether there will be a pre-proposal conference for firms interested in responding to the RFP
- ▶ Name of the contact person if further information is needed to respond to the RFP
- ▶ Number of copies of the proposal that must be provided
- ▶ Due date of the proposal
- ▶ Timeline for each stage of the process, including selection of finalists, firm interviews and award of engagement (this information is often presented in a table format for easy reference)

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## Administrative Matters

The RFP should provide a description of the nature of the entity. The following information should be included in this section:

- ▶ Type of entity (corporation, not-for-profit, etc.)
- ▶ Fiscal year end
- ▶ Name of the auditor's principal contact with the organization
- ▶ Name of the individual (or firm) who prepares the entity's financial statements, including interim financial statements, if applicable
- ▶ The various locations of the organization and the location of personnel files and payroll information related to each location
- ▶ Locations of key company contacts assisting with the audit
- ▶ Whether SOC 1<sup>SM</sup> reports are available from service organizations (SOC 1 reports examine the internal controls likely to be relevant in an audit)
- ▶ Type(s) of SOC 1 reports issued
- ▶ Date(s) when SOC 1 reports are available
- ▶ Name of party that performs SOC 1 engagement, if known
- ▶ Information regarding the availability of prior year auditor's working papers, including where they are located, how access will be provided, and when during the process the predecessor auditor may be contacted
- ▶ Expected due dates for completion of each service to be rendered
- ▶ Whether the proposed fee should be determined on a flat fee, flat fee plus expenses, hourly fee or hourly fee plus expenses basis

## Scope of the Engagement

The RFP should describe the services to be provided. It should describe the scope of the work and any special considerations, including a discussion of specific requirements and parameters to ensure the auditor's proposal is submitted successfully. From this information, the respondent should have a clear understanding of what should be included in the proposal, and what steps and timelines must be met for proposal consideration. Include the following information in this section:

- ▶ Number of years that should be covered by the proposal
- ▶ First year covered by the proposal
- ▶ Whether any work is performed by an internal audit function
- ▶ State that the audit must be performed in accordance with generally accepted auditing standards
- ▶ Whether any other services are expected of the CPA firm (such as preparation of tax returns)
- ▶ Whether the financial statements and auditor's report will be part of SEC filings
- ▶ Whether the CPA is expected to attend regular or special meetings with management, governance committees or other interested parties
- ▶ Description of any significant issues not described above (for example, unique accounting circumstances, consolidations needed, and known areas of difficulty, such as hard-to-value investments and discovery of fraud)



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## Proposal Content and Other Submission Requirements

### *Firm Information*

- ▶ Size, location and history of the CPA firm
- ▶ Whether the firm is a member of the AICPA Employee Benefit Plan Audit Quality Center, Governmental Audit Quality Center or Center for Audit Quality
- ▶ Number of clients in your industry
- ▶ States in which the firm is licensed to practice
- ▶ Firm references — especially from similar type entities — and specific contact information
- ▶ The firm's latest Peer Review Report and firm's response, if any
- ▶ Whether the firm is subject to any current litigation
- ▶ Whether the firm has been the subject of any AICPA or state CPA society Ethics referrals
- ▶ Whether the firm meets the independence standards of the AICPA (and SEC if applicable)
- ▶ The firm's working paper retention and access policies and requirements
- ▶ If the financial statements will be included as part of an SEC filing, whether the audit firm is registered with the PCAOB
- ▶ Whether the firm has insurance coverage (errors and omissions, workers' compensation, etc.)

### *Personnel Information*

- ▶ Managing partner of the CPA firm
- ▶ Partner in charge of the CPA firm's audit practice for your industry, if applicable

- ▶ Partner in charge of the audit
- ▶ Expected levels of staffing and supervision
- ▶ Prior industry experience and training of the partner in charge of the engagement and other key firm personnel pertinent to the engagement, including continuing professional education specific to your industry in the past three years

### *Engagement Information*

- ▶ Audit approach
- ▶ A detailed fee schedule for each service to be rendered
- ▶ Reports to be issued
- ▶ Expected completion dates for each portion of the engagement
- ▶ Expected level of assistance your staff will provide to the audit firm
- ▶ Information that is expected to be provided to the CPA
- ▶ Work space requirements of the firm
- ▶ Tax or other professional services the firm is able to provide

## Proposal Evaluation

The RFP document can clearly outline the proposal evaluation process. A properly defined evaluation process promotes consistency and fairness in the selection process and will reduce the time spent assessing the respondents' qualifications and experience. This section should describe:

- ▶ Elements of the proposal that will be specifically evaluated (for example, whether the firm is a member of an AICPA quality center, technical experience, industry expertise, etc.)

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- ▶ Methodology for scoring the proposal
  - ▶ Steps involved in the selection process
  - ▶ A right-to-reject clause

### Appendixes and Attachments

Appendixes and attachments can be used to accompany the body of the RFP for the purpose of providing relevant information to prospective respondents. The following is a list of information that you may want to provide to all respondents as appendixes or attachments to the RFP:

- ▶ Copy of last audited financial statements, including the auditor's report
- ▶ Copies of interim financial statements, if applicable

### Proposal Evaluation and Auditor Selection

Consider the following information during the proposal evaluation and selection process:

- ▶ Licensure by the appropriate state regulatory authority
- ▶ Independence of the firm
- ▶ Experience and professional development

After the due date for proposal submission has passed, you can begin the technical evaluation process. The technical evaluation is important because it provides a systematic framework for selecting an auditor based on the requirements contained in the RFP. The review of the auditors' proposals and qualifications should be thorough, uniform and well-documented.

Before beginning your technical review of the document, check to see that the firm has addressed all items mentioned in your RFP. For those proposals that are complete and have addressed all relevant areas, you should determine a level of minimum standards for evaluating the information provided by the respondent. Using minimum standards is an effective and efficient

tool to limit the number of proposals that will be reviewed. If certain respondents do not address all relevant issues or do not possess the minimum standards, you may wish to eliminate their proposals from the evaluation process.

It is recommended that you perform separate evaluations of the proposals based on technical criteria and price. While the price for the work to be performed is a factor in the selection process, your organization is likely to get a high quality audit at a fair price if both price and technical ability are taken into consideration in selecting a successful respondent. *Remember, the lowest price does not guarantee a quality audit.* As mentioned previously, only after the technical evaluation is complete and the qualified respondents have been identified should you review the prices offered by the qualified respondents.

Once you have selected the finalists, invite each firm to present and discuss its proposal letter. An oral presentation allows for questions to be asked and answered, which promotes better understanding of the proposal. This is your opportunity to see the proposal team demonstrate insight into your industry and its ability to work well with you and others involved in the audit. Should you feel you need more information or explanations from certain respondents before a decision can be made, you should contact those respondents that are contenders to obtain the necessary information (be careful during this phase of the process to not discuss or reveal proprietary information submitted by other respondents).

## DOCUMENTING THE AGREEMENT

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The auditor is required by professional standards to document the agreement to provide services in writing and, as such, will send you an engagement letter, which documents the agreed-upon terms of the audit engagement. A signed written agreement represents a contract and is binding upon your organization and the auditor. For that reason, consider seeking the advice of legal counsel on the form and substance of the document when reviewing the agreement. At a minimum, the written agreement should contain the following:

- ▶ Names and parties to the contract
- ▶ Audit scope, objectives and purpose
- ▶ Audit schedule and deadlines for work to be performed
- ▶ Audit cost
- ▶ Reporting package and its format
- ▶ Type and timing of audit evidence to be provided by the auditee
- ▶ Professional standards to be followed for the audit
- ▶ Management's responsibilities

In addition, you should consider including the following items about the auditor/auditee relationship, changes in the scope and quantity of work required, and access to and ownership of audit products:

- ▶ A statement that the auditor is an independent contractor
- ▶ A statement that the auditee has the right, by written notice, to make changes or additions to the work within the general scope of the agreement and that, in such cases, an equitable adjustment to the price of the audit will be made using specified rates

- ▶ A description of how the auditor should handle situations in which the auditor does not agree with changes and additions in work to be performed, including how the auditor is to communicate this to the auditee; for example, disagreements should be in writing and communicated within a specified time period; a description of the dispute resolution process also should be included
- ▶ A statement that the auditor owns its audit documentation and a specified period for which that documentation must be retained by the auditor
- ▶ A statement that addresses access to audit documentation and copies that may need to be provided to regulatory reviewers
- ▶ A statement that the audit reports rendered by the auditor to the entity are the exclusive property of the auditee for use subject to applicable laws and regulations

## ADDITIONAL RESOURCES

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### GAQC Resources

[aicpa.org/GAQC](https://aicpa.org/GAQC)

The GAQC has prepared tools including:

- ▶ The [Auditee Resource Center](#)
- ▶ A discussion on [Procuring Governmental Audit Services](#)
- ▶ [Member listing](#)

### EBPAQC Plan Sponsor Resource Center

[aicpa.org/EBPAQC/PlanSponsorResourceCenter](https://aicpa.org/EBPAQC/PlanSponsorResourceCenter)

The EBPAQC has compiled helpful tools and resources for plan sponsors, administrators and trustees including:

- ▶ The Importance of Hiring a Quality Auditor to Perform Your Employee Benefit Plan Audit
- ▶ Employee Benefit Plans — Financial Statement Audits
- ▶ Member listing

### Peer Review Resources For The Public

[aicpa.org/peerreview](https://aicpa.org/peerreview)

The Peer Review Public File provides a list of public accounting firms and their enrollment status in the AICPA Peer Review Program.

Information in the public file includes the firm's most recent peer review report, letter of comments (if any) and the firm's response (if any) for firms that are members of the EBPAQC, GAQC or PCPS, or firms that have voluntarily requested to have their peer review documents publicly available.



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