



**STAFF REPORT
ACTION REQUIRED
with Confidential Attachment**

External Audit Services Contract Extension – Results of Negotiations

Date:	February 8, 2008
To:	Audit Committee
From:	Treasurer
Wards:	All
Reason for Confidential Information:	This report involves the security of property belonging to the City or one of its agencies, boards and commissions.
Reference Number:	P:\2008\Internal Services\Treasurer\ac08001Treasurer (AFS#6469)

SUMMARY

This report outlines the results of the negotiations to extend the external audit services contract with the Ernst & Young LLP for the fiscal years 2008 and 2009 and the recommendations that result. The approval of this extension will assist the Office of the Treasurer in completing its major projects that are taking place during this period. It will also ensure that the Office of the Treasurer receives consistent advice over the term of the Capital Asset Accounting Project that is taking place during this period.

RECOMMENDATIONS

The Treasurer recommends that:

1. Council authorize a two-year contract extension with Ernst & Young LLP for external audit services for fiscal years 2008 and 2009 as per the fee schedule outlined in Confidential Attachment 2 and under terms satisfactory to the Auditor General and the City Solicitor;
2. Council authorize the public release of the confidential information in Attachments 1 and 2 upon Council’s approval of this contract extension to Ernst & Young and Ernst & Young’s signing the contract, and

3. the appropriate City officials are directed to take the necessary action to give effect thereto.

Financial Impact

If the total contract award identified in the confidential attachment to this is approved by Council, the City's portion of the audit fee increase will be included in the Auditor General and non program 2008 and 2009 budget. The audit fee increase for the ABCs and Pension, Payroll and Employee Benefits Division will be absorbed in their respective 2008 and 2009 operating budgets.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

Council approved the existing five-year contract with Ernst & Young at the Council meeting of June 24, 2003. The Auditor General has the responsibility for the management of the external auditor contract and has been consulted in the development of this report and requested that the Treasurer initiate this request.

At the December, 2007 Council meeting, approval was given to the Treasurer to negotiate a two year contract extension with Ernst & Young.

<http://www.toronto.ca/legdocs/mmis/2007/au/bgrd/backgroundfile-8232.pdf>

ISSUE BACKGROUND

The five-year contract for external audit services with Ernst & Young is set to expire with the completion of the 2007 financial statement audit. In the normal course of business, the Auditor General would issue an RFP in late 2007 and recommend the preferred bid to Council in the spring of 2008. Should the RFP proceed and an auditor other than Ernst & Young win the competition, a transition plan would be executed to change auditors in the summer and fall of 2008. The Divisions within the Office of the Treasurer would bear most of the transition work at a time when they are engaged in a number of major projects.

In addition, the Office of the Treasurer requires immediate and consistent advice from the City's external auditor as it works through the Tangible Capital Asset Accounting project that must be completed by the end of 2009 to meet the Public Sector Accounting Board's (PSAB) new reporting requirements for tangible capital assets.

COMMENTS

Negotiation Process with Ernst & Young

Prior to the holiday break, the Treasurer and the Auditor General requested Ernst & Young to provide a fee proposal for the two-year contract extension. Ernst & Young was requested to develop the fee proposal on the basis of changes to the scope of work since their original proposal in 2003 and on the basis of “reasonable” salary escalation experienced since 2003. The fee proposal was delivered and reviewed in early January 2008.

Factors Influencing the Fees

There are three factors that have influenced the cost of the audit: Changes in audit scope, changes in audit standards and the salaries of staff. Each of these factors are discussed briefly below.

Audit Scope Changes

The extent of the audit work required has changed since 2003. Under the current contract, Ernst & Young, with the prior agreement of the City, is allowed to bill extra for work that was not contemplated under the original RFP. For example, since 2003, the City has purchased a landfill site and Exhibition Place has entered into significant new agreements such as the one with National Soccer Stadium. The base fee shown in Confidential Attachment 1 includes net scope of work adjustments.

The added scope would attract higher fees in an RFP process as well.

It is important to note that the audit fee proposed does not include the extra audit work anticipated for the capital assets that will be reported for the 2009 fiscal year. There is not enough information at this time for E&Y to base a credible quote on. In checking with other municipalities that recently went out for RFP, the fees quoted did not include tangible capital assets.

Audit Standard Changes

As a result of the high profile accounting scandals in the US (e.g. Enron, World Comm), both the Canadian and American audit community increased the generally accepted auditing standards (GAAS) that public accountants must follow. The increase in standards has resulted in increased hours spent on every audit and an increase in senior level staff involvement in the audit. E&Y did not charge extra for the increased standards during the term of their original 5 year engagement. The fees proposed include an additional amount, as shown in Confidential Attachment 1, to account for the increase in audit standards.

The added GAAS requirements would attract higher fees in an RFP process as well.

Staff Salary Changes

The US accounting scandals also triggered the Sarbanes-Oxley Act in the US that requires CEOs, CFOs and their auditors to certify the adequacy of the corporation's internal controls. This led to a huge demand for accountants which in turn drove up the salaries of qualified accountants. E&Y have proposed hourly rates that have increased by a factor of approximately 5.5% annually since 2003. E&Y maintains that the resultant hourly rates still contain a significant discount. The addition to the fee is disclosed in confidential Attachment 1.

The added pressure on staff salaries would be reflected in higher fees in an RFP process as well.

Confidential Attachment 1 reconciles the proposed fee to the original fees quoted in the 2003 RFP process. Confidential Attachment 2 is a summary of fees proposed for the City and its ABCs. Staff believe that the new fee proposed is very competitive and it would be unlikely that it would be improved by an RFP process.

CONTACT

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SIGNATURE

Cam Weldon
Treasurer

ATTACHMENTS

Confidential Attachment 1 – Price Proposal Reconciliation to Original Fee

Confidential Attachment 2 – Proposed Fees by City Entity