



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Services Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	May 8, 2017
SUBJECT/REPORT NO:	External Audit Services - Authorization to Negotiate (FCS17048) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Stephanie Nagel (905) 546-2424 Ext. 3020
SUBMITTED BY:	Mike Zegarac General Manager Finance and Corporate Services Department
SIGNATURE:	

RECOMMENDATION

That the General Manager of Finance and Corporate Services, or their designate, be authorized to enter into negotiations with KPMG LLP to provide external audit services to the City of Hamilton for the 2017-2021 fiscal year ends and that the results of those negotiations be brought back to a future Audit, Finance and Administration Committee meeting for final approval.

EXECUTIVE SUMMARY

KPMG is the current provider of the City of Hamilton's (City) external audit services having been the successful proponent of a 2011 Request for Proposals, C12-12-11 and have been providing services under this contract for the audit years ending 2012-2016. KPMG is familiar with the City of Hamilton's entities and has provided exceptional service and commitment to the City over the last five years. KPMG has approached senior management with a written letter indicating that they would like to retain the City as a client and if we proceed with a contract renewal they have proposed to hold audit fees for the City of Hamilton for the next five years at the same amount of \$225,000 per annum as it has been for the last five years. This amount covers the majority of the current and recurring audits required for the City and its' many associated entities and programs. Staff proposes working with KPMG to further negotiate on pricing of the audits on the initial schedule and to look towards including some remaining audits that

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stand outside the scope of the initial proposal. The intent is to achieve efficiencies on the audits and to ensure that we have prices set for most known entity audits to be completed for the next five year period.

Alternatives for Consideration – See Pages 5

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: KPMG’s current contract is at a cost of \$225,000 per year. This amount covers the City’s consolidated audit as well as a number of entity and program audits – 44 audits are listed in the proposal. Most notably, Hamilton’s Farmers Market has been added to the schedule of audits for 2016 as a separate audit and is not included in the current proposal cost.

Staffing: Not issuing a Request for Proposal (RFP) will save both the Procurement and Accounting Service staff time that would be needed to compile an RFP. Also, a new audit firm would need to familiarize themselves with the City of Hamilton processes, controls and our many programs and related parties which generally results in extensive City staff hours in the initial transition year.

Legal: N/A

HISTORICAL BACKGROUND

The *Municipal Act, 2001* c.25, 296(3) indicates that “An auditor of a municipality should not be appointed for a term exceeding five years.” The intent of this section is to ensure that the external audit relationship is reviewed every five years. This allows for the Municipality to negotiate with a current vendor for reappointment or to go to market with a RFP for services, either to seek better pricing or to revise for services and/or needs of the organization that may have changed over time.

In 2011, a one year contract extension was granted to the incumbent audit firm, Grant Thornton C6-10-06 to provide external audit services for the 2012 year end in the amount of \$285,000. The intent of the extension was to provide staff the time necessary to proceed to an RFP process. The City did issue an RFP C12-12-11, “Professional Consultant Required for External Services” on November 25, 2011 which closed January 20, 2012. The result of this process was the appointment in June 2012 of KPMG, who had been a past auditor for the City. Their submission included the necessary experienced Municipal audit staff and City of Hamilton specific experience with a savings of \$60,000 per year with the new contract coming in at \$225,000 per year for the fiscal years 2012-2016.

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As per the City of Hamilton's Procurement Policy and associated By-Law 16-070, staff is required to seek Council direction on the type of procurement process to be followed for the acquisition of the Good and/or Service where there is an incumbent vendor on a City Corporate contract which is of a highly sensitive nature, due to the risk associated with financial loss, confidentiality or the handling of sensitive information. This direction comes from Procurement Policy #4 – "Determining the Procurement Policy, Section 4.5(5)".

KPMG's current contract for external audit services expires after completion of the 2016 scheduled audits. KPMG has provided management with a letter dated December 20, 2016, with a proposal for City of Hamilton and Hamilton Utilities Corporation external audit services for the fiscal years 2017-2021. This proposal covers the majority of the current City and related entity audits for the same price as the previous five year contract, \$225,000 per year for the next five years. It should be noted that much has changed over the last five years as it relates to external audits and the entity relationships in that some entities or programs are no longer part of the City's audits, while others have been added. This justifies the need to review the proposal and further negotiate to ensure relevant costing exists for the proposed audits and for the inclusion of all current known audit needs.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

As noted, staff is seeking direction from Council in compliance with the Procurement Policy and associated By-Law 16-070. In particular, Policy #4 – Determining Procurement Policy- Section 4.5(5).

RELEVANT CONSULTATION

In discussion of this report with the Manager of Procurement, we felt it prudent to proceed with a brief survey of Municipalities to obtain a better understanding of the current external audit market and the approach taken by other Municipalities in the last one to two years. A survey was developed by the Manager of Accounting Services in conjunction with the Manager of Procurement with a few questions such as:

- when the last auditor appointment took place
- terms of the contract
- details of whether they went to RFP or reappointed after negotiation
- if a RFP was issued, how many bidders applied.
- any pricing increases/reductions
- any other info they would like to share on the process/results.

This survey was sent by Procurement through the members list for the Ontario Public Buyers Association on February 14, 2017. We received eleven responses from the

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survey and additionally sought out information on three other recent audit appointments easily found through internet/website searches. This is a small subset of Municipalities, but, we were seeking information from the last two years and generally term for audit firms are appointment for five year terms.

Of those respondents, we found that:

- 29% negotiated with their current vendors for a contract renewal period
- 64% use KPMG as their auditor
- Of the five that went to tender, four (80%) who were with KPMG originally stayed with KPMG after tender.

As noted, this was a small sample, but we were able to determine that there was no consistent pricing approach, some municipalities stayed with current vendor, while some switched vendors, but the amount paid was higher, lower or neutral with no prevailing market trend. The most notable information from this survey was that for large and complex Municipal entities, the number of external auditors who have experience and size to accommodate is only a few and of those big firms not all will necessarily bid. Most of Municipalities received three to four bidders if they went to market. Lastly, only two of the ten (20%) respondents who went to market with an RFP actually switched external audit firms.

ANALYSIS AND RATIONALE FOR RECOMMENDATION

The City of Hamilton requires external audit services specific to Municipalities and in a complex and large scale manner. In seeking an external audit firm, the size and needs of the City would limit potential respondents to large firms with specific large Municipal audit background. The single tier structure and multiple entities and programs make the need for an experienced audit team with relevant Municipal experience paramount to success. The audits need to be timely and effective so as to not overburden staff time and as such, the audit firm has to have a large number of their own staff of experts to assign appropriate teams to our many varied areas.

KMPG has a long standing history in Hamilton and the surrounding communities. They have a staff of over 100 and their Hamilton office serves Brantford to Milton to Fort Erie with a local presence. Their regional office provides for access to our many locations with ease of travel and should reduce costs and time for the vendor, while improving access for staff to the audit team. KMPG has one of the largest audit, advisory and tax practices in the area.

City departments and staff are satisfied with the services that KPMG has provided over the past five years. They are aware of our many entities and audit requirements and are familiar with our controls and processes.

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KPMG has expressed an interest in maintaining the City of Hamilton as a client and has reached out to senior finance staff with a letter dated December 20, 2016 proposing to keep our base audit fees at \$225,000 per year for the next five years (2017-2021). This would mean a period of ten years without an audit fee increase if we choose to reappoint our current external audit firm. Our fees in 2011 with our previous firm were \$285,000 which is \$60,000 higher per year.

Staff within Procurement and Accounting Services would need to set aside time for a full RFP process, which could be saved for other tasks if the existing auditor is reappointed. The pool of large audit firms limits the number of proposals that will qualify and any subsequent firm would require a large amount of time and City staff time in the first and second year of an audit term to become informed enough of practices and controls.

ALTERNATIVES FOR CONSIDERATION

The recommendation in this report is to negotiate with our current external audit firm for a new five year contract with the many reasons for this approach having been cited throughout this report. The intent would be for staff to come back to Council with the results of the negotiation, at which time, Council could either accept a new contract with the current vendor or reject the contract and ask staff to go to the market with the RFP for the service contract.

The alternative approach to negotiation is to execute a competitive process in accordance with the City's Procurement policies and procedures. For external audit services the most used procurement approach is to prepare an RFP for external audit services and go to market for submissions. It should be noted that with an RFP the Municipality can still review audit firms based on skills and experience with pricing being one weighted factor. The alternative is to go with a two envelope system where all proponents are scored on the qualitative factors and then review the pricing envelopes for the participants who pass the first phase with a minimum points requirement.

An advantage of going to market is that it is a competitive process that is meant to result in a price based on the current market. If the result of the process is a new audit firm, the new auditors may provide a different perspective on the annual audit. That being said, going to market doesn't mean that the organization gets the best pricing for the service or even guarantees the same or better pricing than what is being suggested as a base offer from KPMG. Although, in an RFP the Municipality doesn't have to take the lowest price, the difference in service levels may not be given the same weighting as price. The base service from firms and their knowledge and expertise differs. The burden of staff time to respond to a new audit firm and for that new firm to familiarize themselves with the City of Hamilton, current processes, By-Laws and entity relationships could be significant in the first couple of years of a new contract.

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Consistency of knowledge in terms of programs and contacts is lost with a change in firms. There are no current issues in terms of service, audit timing and staffing of the external audit with our existing auditors. A new audit firm could propose times or staffing that do not align with our needs which would then have to be worked through. As other auditors may need to reallocate their internal resources or may even have to hire new audit staff to accommodate taking on a client of our size.

The RFP process is open and transparent and is often used by Municipalities as the method to review their auditor appointment every five years. As noted there are pros and cons to both approaches; however, staff's recommendation is to proceed with negotiating with our current vendor who is providing exceptional service. KPMG, is knowledgeable of our systems and processes, are a large widely used Municipal auditor with a local presence and whose staff has the skills to handle a municipality of our size. The intent is to get the best pricing for the service that we currently experience and thus provide a stable budget item for the next five years. If staff is directed to go to market, we may need to negotiate a one year extension to the current contract to provide the time and resources to complete a proper RFP process.

ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN

Economic Prosperity and Growth

Hamilton has a prosperous and diverse local economy where people have opportunities to grow and develop

Our People and Performance

Hamiltonians have a high level of trust and confidence in their City government.

APPENDICES AND SCHEDULES ATTACHED

NA

SN/dw