



CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Services

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	August 16, 2017
SUBJECT/REPORT NO:	Appointment of External Auditor 2017-2021 (FCS17073) (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:	

RECOMMENDATIONS

- (a) That the firm of KPMG LLP be appointed as the municipal auditor of the City of Hamilton for a five year term, inclusive of fiscal years ending 2017-2021, at a flat fee of \$215,000 fixed per year based on the attached Appendix "A".
- (b) That the Police Services audit of operations be removed from the schedule of required annual audits.

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 (RFP), C12-12-11 and have been providing services under this contract for the audit years ending 2012-2016. In December 2016, KPMG had approached senior management with a proposed contract renewal keeping our current \$225,000 per year audit fee for the next five years. Financial Services staff brought Report FCS17048 to the Audit, Finance and Administration Committee on May 8, 2017, to seek authority to negotiate with KPMG and to bring back the results of such efforts to a future Committee meeting. This report and the recommendations are a follow-up to the initial May 2017 report. The intent was

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to achieve efficiencies on the audits and to ensure that we have prices set for our known annual audits for the next five years.

Alternatives for Consideration – See Page 6

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: KPMG's contract price for 2012-2016 was \$225,000 per year based on the 2011 RFP. The amount covered the City's consolidated audit, as well as a number of entity and program audits. Forty nine audits were listed in the original proposal. Audit needs and entities included/excluded have changed over the past 5 years. The current list in Appendix "A" contains forty audits at a total price of \$215,000. This represents a \$10,000 or a 4.4% reduction in total fees. The agreement with KPMG is to keep the base price flat at \$215,000 annually for the 2017-2021 audit years. It should be noted in 2011, audit fees were at \$285,000 per annum based. The recommended proposal for the next five years is \$70,000 lower than the fees were in 2011.

Staffing: Not issuing a Request for Proposal (RFP) will save both the Procurement and Accounting Services staff time that would be needed to compile, issue, review and evaluate 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 services and/or needs of the organization that may have changed over time.

In 2011, a one-year contract extension was awarded to the incumbent audit firm, Grant Thornton, C6-10-06 to provide external audit services for the 2011 fiscal year at a cost of \$285,000. The intent of the extension was to provide staff the necessary time to proceed with an RFP process. The City did issue RFP C12-12-11, "Professional Consultant Required for External Audit Services" on November 25, 2011 which closed January 20, 2012. The result was the appointment in June 2012 of KMPG, who had been a past City auditor. Their submission of \$225,000 per year included the necessary

experienced Municipal audit staff and City of Hamilton specific experience with a savings of \$60,000 per year for the five years of 2012-2016.

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)". As such, staff brought Report FCS17048 to Committee on May 8, 2017 to seek authority to negotiate with KPMG on a five year contract renewal. Approval was granted by Committee and Council.

The Director of Financial Services, Taxation and Corporate Controller along with the Manager of Accounting Services proceeded with negotiations over the last couple of months which involved reconciliation of current annual audit needs and a review of the costs of the audits. The many discussions and two formal meetings with KPMG have resulted in the proposal from KPMG to cover the 40 annual audits as identified in Appendix "A" for a cost of \$215,000 per year for the next five years. As noted, audit needs have changed with many removals and also some corresponding additions to the schedule. The final result is a fee reduction of \$10,000 per year from the prior five years. KPMG has agreed to keep this fee flat for the 2017-2021 audit periods. See Appendix "B" for the analysis of pricing by audit and for a more detailed explanation see below in the Analysis section of this report.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

Staff followed Procurement policy, in particular Policy #4- Determining Procurement Policy- Section 4.5(5) in seeking approval to negotiate with KPMG in a prior report. Staff is now seeking Council authorization of the proposed external audit fees and to appoint KPMG as the City's external auditors for the 2017-2021, five year audit period. This complies with the *Municipal Act, 2001* c.25, 296(3).

RELEVANT CONSULTATION

In Report FCS17048, dated May 8, 2017, it was noted that Accounting Services sought the assistance of Procurement to consult other Municipalities with recent audit term expiry's to seek market conditions and results through a survey sent to the members of the Ontario Public Buyers Association on February 14, 2017. The sample was small but, some results were conveyed back – 30% negotiated with their current vendor, five KPMG clients went to tender with only one switching vendors. Of the ten that did issue RFP's only 2 switched vendors. Most notably, Hamilton is a large and complex municipality which limits the vendor pool for this type of engagement. There are only a

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few audit firms with the capacity and experience to provide external audit services and not all of them would necessarily bid on an issued RFP.

In addition, the Finance Manager and Chief Accountant for Police Services at the City of Hamilton is aware of this Report and is in agreement with Recommendation (b) to remove the separate audit of operations for Police Services from the schedule of required annual audits. Police Services will continue to be audited within the scope of the City of Hamilton's annual external audit.

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 audits, 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.

KPMG expressed interest in maintaining the City of Hamilton as a client and had 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). Staff recognized the need for a review of current audits and the need to include known audits not acknowledged in the December proposal letter.

Staff sought Council approval in May 2017 to negotiate with KPMG on pricing for a concurrent five year contract. The idea was to fine tune our audit needs and obtain efficiencies while ensuring inclusion of more recent additions to our audits required. Negotiations have been conducted over the last two months resulting in the final list of City audits and corresponding costs provided in Appendix "A" to this Report. The net result is a decrease of \$10,000 or 4.4% to an annual cost of \$215,000 per year which would be fixed for the next five years. This allows for a stable budget allocation and known service levels.

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The details behind the negotiations are that in 2012 the audit list contained 49 audits, some of which are no longer required. The remaining 36 audits from the original RFP represent a new 2017 base with original 2012 prices adding to \$184,400. KPMG agreed to a fixed price for the next five years (2012-2017), but asked to be able to increase these original 2012 audits by an inflation factor given those prices were held stable for 2012-2016 audit years. KPMG proposed an average increase of 7.5% for the five years (2012-2016) which works out to 1.5% per year. This is in-line with Consumer Price Index (CPI) for the period. Statistics Canada data for CPI by Province (Ontario) for All-Items indicated CPI over the same five year period at 7.8%. KPMG applied an inflation amount which works out to an average of 7.5% to those existing 2012 audit prices resulting in a \$13,800 increase. In addition, four new audits were added to the base list for 2017-2021, they have been previously billed based on actual hours and current rates with KPMG. These new audits total \$16,800 in cost and include the most recent addition of the Farmers Market audit and their required corporate tax return. The compilation of the original base audits still required for 2017 (\$184,400), inflation on that base (\$13,800) and the additions of new audits (\$16,800) total to \$215,000 for the KPMG proposed annual audit fees for a new 2017 base audit list of 40 audits. See Appendix "B" for the analysis on a per audit basis and a more detailed representation of the changes from 2012 to the new 2017 proposal. This annual fee is \$70,000 less than what the City was paying in 2011 before the switch to KPMG. They had the lowest bid in the 2011 RFP and are maintaining their lower cost and preferred service levels in this recent proposal for the next five years.

Within the recommendations of this report is the removal of the audit on Hamilton Police Services operations. The current audit costs \$10,000 annually and was originally requested outside of the regular audits due to the concerns of a citizen. The General Issues Committee approved this annual audit of police operations in 2015, Report FCS15081. Police Services have been separately audited on their operations for 2015 and 2016 fiscal years with no audit findings. Hamilton Police Services are consolidated into the City of Hamilton's annual financial statements and are part of the City's audit. This additional audit is not required and it is suggested that we cease to include this in an annual audit plan. This audit has not been included in the list of base audits in Appendix "A" for 2017-2021.

Should Council not approve the recommendation to appoint KPMG LLP for an additional five year term, then, staff would need to negotiate a one year extension to allow for the time to proceed with a RFP process. Staff within Procurement and Accounting Services would need to set aside time to conduct a full RFP process. Should the RFP result in a change in audit firms then a large amount of City staff time in the first and second year of an audit term is required to adapt to the practices and controls of the new audit firm and to familiarize the audit firm with the City's processes, financial systems , policies, procedures and financial controls.

ALTERNATIVES FOR CONSIDERATION

The recommendation in this report is to accept the negotiation with KPMG, as authorized by Council, and appoint KPMG as our auditors for the five year period of 2017-2021 at an annual cost of \$215,000 for the list of audits as presented in Appendix "A".

An alternative would be to negotiate a one year extension with KPMG LLP and to issue an RFP for External Audit Services. The advantages of going to market are that it is a competitive process that should lead to a price based on the current market, additionally some would say that switching auditors provides a different perspective on the financials. 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 by KPMG. There are costs for a proponent to prepare a bid to respond to an RFP. Staff estimate this cost to be \$15,000 to \$20,000 and the proponent typically looks to recover these costs over the term of the contract. These costs would also be incurred by KPMG LLP and would be considered in pricing their submission.

The intent of the negotiations with KPMG was 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 would need to negotiate a one year extension to provide the time and resources to complete a proper RFP process as the auditors start their preliminary audit work late in the Fall.

ALIGNMENT TO THE 2016 – 2025 STRATEGIC PLAN

Community Engagement and Participation

Hamilton has an open, transparent and accessible approach to City government that engages with and empowers all citizens to be involved in their community.

Our People and Performance

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

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" – "City of Hamilton and Hamilton Utilities Corporation Proposal for External Audit Services for 2017-2021" from KPMG

Appendix "B" – "Cost comparison of City audits from 2012 RFP to new 2017 Proposal"

SN/dw