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City of Burlington

City Hall, Room 20, 149 Church Street, Burlington, VT 05401

Voice (802) 865-7000

Fax (802) 865-7014

TTY (802) 865-7142

MEMORANDUM

TO: The Board of Finance

FROM: Claire Shepard, Chief Accountant

A handwritten signature in blue ink that reads "Claire Shepard".

DATE: March 15, 2010

SUBJECT: Recommendation for City Auditors

Recommendation

In accordance with Section §156 of the City Charter, we recommend to the Board of Finance the selection of the following City auditors for the fiscal years ending June 30, 2010 through Fiscal Year ending June 30, 2014 (five fiscal years).

Sullivan, Powers & Company, CPA's of Montpelier, Vermont for the City of Burlington Financial Statements (all City/School Departments except B.E.D.) and the Single Audit for all Federal Grants &

KPMG LLP, with a local office in Colchester, Vermont for the Burlington Electric Department and the Joseph E. McNeil Generating Station Financial Statements

Request

We request that the Board of Finance adopt a motion at your next meeting, March 22, 2010, to approve the selection of auditors for the prices they propose and under standard contract terms and conditions.

Should the Board of Finance adopt this motion, we request that it sponsor the resolution regarding the selection of the City auditors being drafted by our City Attorney for consideration for approval by City Council on Monday March 22, 2010.

Background

In past years, there has been separate audits of the City, Burlington Electric Department and the Joseph C. McNeil Generating Station. The performance of the auditors, Sullivan, Powers and Company for the City portion, and KPMG LLP, for the Burlington Electric Department and Joseph C. McNeil Station, has been satisfactory. The City has solicited bids because the current audit contracts have expired.

AUDIT RFP PROCESS:

RFP posted on City website, advertised, and 9 firms directly invited

Nine firms were invited to bid on the City and Burlington Electric Department Audit RFP. At the same time, the Audit RFP was posted on the City website and advertised. A copy is available on-line and can be obtained by calling Claire Shepard, Chief Accountant. It will also be available at your March 22, 2010 meeting.

Firms that Declined the Opportunity to Bid

Five firms (PW Coopers, Deloitte & Touche, A.M. Peisch, Angolano & Company, JMM, and G.W. Osterman) declined the opportunity to bid. Most of these firms indicated that they did not have the resources to conduct an audit for a city the size of Burlington. Deloitte & Touche stated that because they are out of state, and hotel and travel expense becomes a factor, they know from prior bid proposal experience with other Vermont audit opportunities that they would not be cost competitive.

Respondents and their Proposals

Four firms responded to the RFP; and copies of their bid proposals are available to review. The scope of their respective bid proposals varied as follows:

- BST of Albany, NY: bid on City, Burlington Electric Dept, both or separate
- RHR Smith of Buxton, ME: bid on City audit (not BED)
- Sullivan, Powers & Company – bid on City audit (not BED)
- KPMG – bid on BED (not the City audit)

Evaluation Criteria

The intent of the RFP process is to identify the most responsive and qualified independent auditor(s). The audit procurement process is structured so that the principal factor in the selection of an independent auditor is the auditor's ability to perform a quality audit. In no case is price allowed to serve as the sole criterion for the selection of the independent auditor. Hence, the Respondent's Technical Proposals were evaluated based on their stated Firm Qualifications, Staff Qualifications, Professional Experience, Prior Audit Descriptions, Proposed Approach and Plans, and Cost. In addition, we evaluated Respondents comments during the Pre-Proposal Informational Meeting and the Post Proposal Submission Interviews.

Cost Proposals were evaluated separate from the evaluation of the Respondents' Technical Proposals. (See tables below for a comparison of historical audit expenses and the Respondents' Cost Proposals).

Evaluation of BST (Bollam, Sheedy, Torani & Co, LLP) for the City audit

This Respondent's Technical Proposal raises several concerns (listed below); and their cost proposal ranges from \$100,000 to \$160,000 per year more than Sullivan, Powers & Company Cost Proposal. The major concerns are as follows:

1. BST wants to subcontract with two other accounting firms to complete the audit. The first proposed subcontractor is Gallagher & Flynn of Burlington, VT. Gallagher and Flynn would provide accounting staff reporting to the BST Engagement Manager and BST Auditor in Charge. However, Gallagher and Flynn does not have any municipal audit experience.
2. The second proposed subcontractor is Vanacore, DeBenedictus, DiGiovanni & Weddell, LLP of New York. The audit manager from this firm is a NYS licensed CPA; and is not a Vermont licensed CPA. BST proposes subcontracting the work to this auditor because of his experience

in auditing NYS schools. However, there is no mention of prior audit experience in Vermont; and it appears that the firm is not yet registered with the Vermont Board of Accountancy.

3. BST is proposing a core team consisting of four auditing staff for the City audit. This would be supplemented with selected accountants/CPAs for audits of the school, airport, utilities, and other departments. The core team's prior municipal experience is with cities smaller than Burlington (Troy, Solvay, Oneonta, and Saratoga Springs in NYS) and there is no prior municipal audit experience in Vermont.

4. Ms. A. Radley, BST's Proposed "Auditor in Charge" is not a CPA (she has the less senior title of Associate at BST, and her professional certification is "Certified Government Auditing Professional". The bio of Ms. A. Newell, a more senior manager proposed to work on our City audit, states that she has experience with Single Audits of cities, but her profile does not mention any cities by name. A requirement of the RFP is that experience with size and scope be detailed for each staff person assigned to the audit.

5. The firm BST is not yet registered with the Vermont Board of Accountancy. The City Office of Clerk and Treasurer pointed this requirement out to BST as it is required by Vermont state statutes. Subsequently, BST indicated that they would process an expedited application to register with the Vermont Board of Accountancy. Consequently, if the City wanted to award the contract to BST it would have to be contingent upon them being registered with the State Board of Accountancy.

6. BST was hired by Gallagher & Flynn a year ago to provide a peer review of Gallagher & Flynn. While it is legal for BST's proposal to include Gallagher & Flynn as a subcontractor, it unfortunately causes one to pause and consider the question of the appearance of a conflict of interest and undue influence.

Evaluation of RHR Smith & Company (City audit)

According to their Technical Proposal, RHR Smith & Company's specialty is governmental audits (including schools and utilities). The firm provided a long list of municipal audits in Maine, but during a interview with the Owner of this firm, he indicated that their municipal audit experience involved cities that are about one-third the size of Burlington. (e.g. Kennebunk, Kittery).

In addition to not having experience in auditing a city the size of Burlington, this Respondent does not have experience auditing any municipalities in Vermont and has no prior telecom auditing experience. However, the Respondent is currently auditing CCTA and Green Mountain Transit; and in future years, we would be interested in this firm's proposals if they were able to address some of the issues just mentioned.

Further, this Respondent's proposal seems to severely underestimate the number of hours involved in performing our City audit. In a telephone interview, the Respondent said that accounting services related to the audit, but not included in their proposal, would increase their proposal by 700 or more hours and at \$85 per hour this increases their Cost Proposal by \$60 to \$80 thousand. Additionally, it seems that the time commitment required in Burlington may be too much for their current staffing levels in that they have many clients in Maine to continue serving.

Evaluation of Sullivan, Powers & Company (City audit)

This Respondent has extensive municipal auditing experience in Vermont and with Burlington's City audit. Listed in their Technical Proposal are 37 other municipal audit engagements, including: Town of Colchester, City of Barre, Village of Essex Junction, City of Montpelier, Town of Rochester, Town of Wilmington.

All three principals assigned to the City audit are properly licensed CPAs in the state of Vermont. The firm is enrolled in the AICPA Quality Review Program; and they completed an AICPA Quality Review in September 2009 and met the quality control standards. This external evaluation confirms that the Respondent's staff has a high level of expertise in all the governmental auditing and accounting standards that the RFP has listed as a requirement for the City audit.

Our experience is that the Respondent has provided a wide range of services in prior years – many of which are unique to municipal clients, such as: Federal compliance auditing and system design and implementation (e.g. implementation of post-employment benefits accounting). The accounting staff from all our City departments appreciate and have given positive feedback on the value of SP&Co's professionalism and expertise. They have proven themselves to be competent, trustworthy, and independent.

In an interview with two principals of this firm, we asked if they could create a schedule for front-loading much of the work so that towards year-end, the information the auditors need from department managers will be audit-ready and the completion of the audit will be on-time. The Respondents fully support this idea and provided some helpful ideas on processes and communications that will enable this to happen.

BURLINGTON ELECTRIC DEPARTMENT AUDIT RECOMMENDATIONS: Fiscal Years 2010-2014

BED recommends the selection of KPMG as our auditor for the next five years. The only other firm to bid was Bollam, Sheedy, Torani, & Co, LLP, CPAs ("BST"). Although BST's fee proposal was significantly less than KPMG, there were numerous reasons for our recommendation to continue with KPMG.

1. BST is not yet registered with the Vermont State Board of Accountancy, and was not at the time of the bid. As mentioned earlier, due to state statutes, if the City wanted to award the contract to BST it would have to be contingent upon them being registered with the State Board of Accountancy. We have no assurance as to when or if the State of Vermont would approve their registration. Our audit fieldwork typically begins in mid-April, making any delay problematic. In addition, the BST Technical Proposal mentions only one Vermont licensed CPA from BST (Lead Partner on the Engagement). Gallagher & Flynn would provide a Vermont CPA, but this person does not have municipal or utility audit experience.
KPMG is registered with the State of Vermont, and the Partner and Audit Manager are licensed in Vermont.
2. BST has not audited other Vermont municipalities and utilities. Vermont has a unique regulatory environment and specific requirements when it comes to electric utilities. This would include rate filings, regulatory asset accounting, sinking fund or economic depreciation, and other matters. Missing this experience would be a big challenge to overcome.

KPMG is (or has been) the auditor on many of the electric utilities in Vermont, including VPPSA (Vermont Public Power Supply Authority), Velco, and other private and municipal electric utilities in Vermont.

3. We have a concern about BST's ability and expertise. For example, at the pre-proposal informational meeting, the BST representative indicated a lack of familiarity with government auditing standards on the consolidation of the Burlington Electric Department audit with the City financials.

KPMG has been our audit firm for the past ten years and we have had no issues with the quality of staff and the audit itself. KPMG is one of the "Big Four" national firms located in Colchester. They have experts from other offices across the country that can be made available to them and us.

4. We have a concern about the quality of the audit. The rates per hour for the staff of BST are comparable to the rates for KPMG staff. In fact, the "Associates" (who put in the most hours on the audit) pay rate is higher than at KPMG. Therefore, they are proposing to do the audit in significantly less time and expense than our current, more experienced audit firm. Given the start-up costs and time to be incurred, as well as the significant travel and overnight expenses (Albany, NY), we are concerned that the quality of the audit could be sacrificed to stay within budget.

KPMG's fee proposal is based upon actual hours incurred. They have completed the last five years of audits on time and with the highest quality. They are a local firm, so would not incur travel and overnight expenses. We are very comfortable with the hours they have included in their proposal. Conversely, BST did not include information on the number of hours assumed. In addition, BST states "this proposal assumes a high level of assistance will be supplied by your personnel, including the preparation of schedules and analyses of accounts". We are concerned that they may require more staff time than previously required, thus costing more internally.

5. The proposal from KPMG met all of the requirements and expectations in the audit RFP. The presentation was exceptional.
6. The cost proposal from KPMG was in line with expectations. The fiscal year 2009 audit cost BED \$55,900 for BED and \$12,600 for the McNeil Station. The proposal for Fiscal Year 2010 is \$56,000 (a \$100 increase) for BED and \$15,000 for the McNeil Station. These are dollar levels we assumed in our budget for fiscal year 2010. The McNeil Station costs went up more than BED in that we are now accounting for Renewable Energy Credits ("RECs"), and this requires more time on their end. The total of the two audits rose 3.6% over fiscal year 2009. The costs for the remaining four (4) years of the contract rise approximately 5% per year.
7. The City's Purchasing Policy and BED's purchasing practice has been to put a premium on awarding contracts to Burlington based contractors. After that a preference for Chittenden County and then to State of Vermont contractors is given. BST is a New York based company.

KPMG is a local, Chittenden County company.

EVALUATION OF COST PROPOSALS

City Only

<i>Fiscal year ending</i>	<i>BST</i>	<i>RHR Smith</i>	<i>Sullivan Powers</i>
<i>June 30,</i>	<i>\$</i>	<i>+ \$60K</i>	<i>\$</i>
2010	295,000	130,235	194,000
2011	311,000	130,235	199,500
2012	327,000	130,235	205,500
2013	343,000	130,235	211,500
2014	359,000	130,235	218,000

RHR Smith: Their bid is based on an estimate of 1330 audit hours and no related accounting work. The Respondent indicated it is typical to add 50% or approximately 700 + hours for related accounting services. At an average of \$85 per hour, add approximately \$60,000 to the RHR Smith cost proposals.

Conclusions:

1. BST is far more expensive than the other two Respondents to the City audit. This is probably due in part to the T&E involved for the staff from Albany and the proposed use of two sub-contracted accounting firms.
2. RHR Smith's quote has a higher degree of risk given that the cost of related accounting services was not included in the Cost Proposal. Grossing this Respondent's bid up by \$60K to account for the required accounting work results in it being slightly less but pretty close to the Sullivan, Powers and Co. quote.

EVALUATION OF COST PROPOSALS

Burlington Electric Department and McNeil Generating Plant

<i>Fiscal year ending</i>	<i>BST</i>	<i>KPMG</i>	<i>Difference</i>
<i>June 30,</i>	<i>\$</i>	<i>\$</i>	<i>\$</i>
2010	50,400	71,000	20,600
2011	51,800	74,250	22,450
2012	53,200	78,000	24,800
2013	54,600	82,000	27,400
2014	56,000	86,500	30,500

Conclusions:

1. The BST quote is below KPMG's by \$20K to \$30K per year; but the BST cost proposal for BED does not include the T&E out of pocket costs that BST included in the quote for the City audit. The T&E cost ranges from \$25K to \$30K per annum for the City audit. If BST does not win the award for the city audit, some T&E will be incurred if BST conducted the BED audit, driving actual costs higher than estimated and leading to the concerns mentioned by BED in its recommendation section of this memo.
2. A comparison of historical and projected KPMG costs indicates that the total of the two audits rose 3.6% over fiscal year 2009. The costs for the remaining four (4) years of the contract rise approximately 5% per year.
3. The KPMG proposal for Fiscal Year 2010 is \$56,000 (a \$100 increase) for BED and \$15,000 for the McNeil Station. These are dollar levels we assumed in our budget for fiscal year 2010.

RECOMMENDATION:

Based on this analysis, we request that the Board of Finance adopt a motion to approve the selection of auditors recommended herein: Sullivan, Powers & Company for the City audit and KPMG for the audit services of the Burlington Electric Department. We ask that you approve the prices they propose and the preparation of contracts with standard terms and conditions.

Please let me know if you would like any other information. Thank you for your consideration of this recommendation.

The cost of audit and related accounting services over the past 5 years:

<i>Fiscal year ending</i>	<i>Sullivan Powers</i>	<i>Comments</i>
<i>June 30,</i>	<i>\$</i>	
2005	201,599	
2006	197,512	
2007	346,781	City accounting staff turnover and vacancies drove delays and costs.
2008	353,019	Several issues required difficult calculations and allocations: underfunding of city pension in 2006 and 2007, BT accounting issues, accounting for self-insurance liabilities, interfund transfers, airport accounting, and corrections to City and School capital assets and debt schedules.
2009	196,955	City's accounting staff has now been performing the same functions for the past two years and as a result SP&Co. has seen significant improvements in the 2009 audit.

Conclusions regarding historical versus projected costs:

There is not a major increase in the cost of auditing services if we can continue to retain our present accounting staff and continue to make the improvements that Sullivan, Powers & Co. has observed in 2009.