

- **Board of Directors**
Special Audit Committee
Executive Committee

May 17, 2000 Board Meeting

8-6

Subject

Award of Contract for Internal Audit Support Services.

Description

This letter seeks authority for the award of a contract for Internal Audit Support Services to the firm of KPMG, LLP, (KPMG) effective July 1, 2000. The contract will be based on the proposal submitted by KPMG in response to Metropolitan's RFP No. 440, which includes a partnering arrangement between KPMG and the Los Angeles accounting firm of Vasquez Farukhi & Company, LLP (Vasquez Farukhi), a certified MBE firm. Under the proposal, Vasquez Farukhi will have a minimum participation of 30 percent of the revenues under the contract. The contract term will cover three fiscal years and the maximum amount payable during that term will not exceed \$1 million. KPMG (with Vasquez Farukhi, as subcontractor) was selected as the most qualified to perform the support services required by the Audit Department based on a competitive process.

During the past several years, the General Auditor has utilized the services of various firms of independent auditors and consultants to conduct audits and special reviews on his behalf. These engagements typically dealt with areas requiring specialized skills or were otherwise necessary to augment the Audit Department's limited personnel resources in meeting the department's responsibilities in a timely manner. In mid-1998, the General Auditor utilized a competitive process to select the firm of KPMG, LLP, to perform designated Internal Audit Support Services, as required, throughout fiscal 1998-99. That agreement, which was ratified by the Special Audit Committee and Board, was for an initial term of one year and a not-to-exceed total of \$200,000.

After a successful first year of experience in utilizing KPMG's co-sourcing services to augment the Audit Department's resources, the General Auditor recommended extension of the agreement for another year and an additional \$200,000 in funding. The extension for fiscal 1999-2000 was approved by the Special Audit Committee in June 1999 on the condition that the General Auditor solicits competitive proposals for the next co-sourcing services contract commencing effective July 1, 2000. The General Auditor agreed and, consistent with that condition, a Request for Proposal (RFP) for Internal Audit Support Services was developed by the General Auditor in March and was issued to a variety of auditing firms. Special Audit Committee Chair Edwards was consulted on the RFP provisions prior to its distribution, including the requirement, for administrative convenience, that all firms submit proposals for services and fees covering a three-year term.

Based on the Audit Department's budget authorization for professional services in recent years, it is estimated that service levels under the new Internal Audit Support Services agreement will approximate \$300,000 per year, with a maximum contractual limit of \$1 million for the three-year period. The amounts actually spent under the proposed agreement will, of course, vary from year to year and will depend on identified needs, work priorities and other factors as may arise. Some additional funding is also available in the Audit Department's operating budget each year in the event separate services of other audit consultants are needed during the term of the support services agreement.

Proposals to provide required Internal Audit Support Services were ultimately received from four firms by the April 13, 2000 deadline. After an assessment of the quality of proposals received, representatives from three of these firms were invited to make presentations of their proposals on April 24 to a selection panel consisting of the Chair and former Chair of the Special Audit Committee, Special Audit Committee member Borenstein, the General Auditor and the Principal Auditor. Upon completion of that process, the panel unanimously selected

KPMG (with Vasquez Farukhi, as subcontractor) as the best qualified to provide the required Internal Audit Support Services to the Audit Department commencing with fiscal year 2000-01. Among the factors which the panel considered in reaching its decision were:

- The extensive experience of both firms in performing general audits, consulting engagements, and internal audit services for other entities, including a myriad of local governmental agencies and utilities.
- KMPG's experience and performance in providing support services to Metropolitan's Audit Department during the past two years.
- The qualifications and experience of the team assigned to work on the engagement.
- The competitive hourly billing rates which are guaranteed for three years.
- MBE/WBE contractual considerations, including the commitment to a minimum of 30 percent participation to KPMG's MBE subcontractor.

It is expected that the contractual arrangements and other conditions pertaining to the Internal Audit Support Services to be provided by KMPG (with Vasquez Farukhi, as subcontractor) will mirror the arrangements currently in place with KPMG. During the past two fiscal years, KPMG performed 15 distinct assignments under Task Orders issued by the General Auditor. The bulk of those audits were performed on a "turnkey" basis, wherein the firm conducted the required assignment on its entirety and issued a written report to the General Auditor upon completion of the task assignment. In other instances, KPMG staff conducted assignments on a "partnering" basis wherein the firm personnel worked in conjunction with and under the direction of Audit Department staff. KPMG representatives also made presentations to Metropolitan management and to the Special Audit Committee upon the completion of several of their assigned projects. Overall, the engagements performed by the firm have been of high quality, timely and cost-beneficial, and the firm's assigned personnel were qualified and professional in carrying out their duties.

The proposed Internal Audit Support Services contract with KPMG is expected to continue the administrative process in place under the existing co-sourcing arrangement. While specific audit assignments have not yet been established, several areas have been identified as likely candidates in which to utilize such support services, including:

- Management requested pre-contract award audits or other priority assignments.
- Specified audits of capital projects, and other construction or consulting services contracts.
- Specified audits of Metropolitan's various water programs and related contractual arrangements with member agencies or other entities.

It is also expected that KPMG and/or Vasquez Farukhi will provide advice or input to the General Auditor on areas of opportunity for future internal auditing efforts, including contract audit services. The scope of all required services will be agreed upon, prior to commencing any assignment, through the use of a Task Order document.

Both KPMG and Vasquez Farukhi have agreed to provide professional personnel for each assignment who are highly qualified and experienced in relation to the tasks at hand. The General Auditor will have the right to direct changes in personnel on any assignment. The firms, and their staffs, will conduct their work in accordance with all applicable accounting and auditing standards. A copy of the hourly billing rates for such services, which will remain in effect during the three-year contract term, is attached to this letter ([Attachment 1](#)).

Policy

Existing policy contained in Administrative Code Sections 2561(a)(3) and 2561(b) specify that the Special Audit Committee shall study, advise, and make recommendations to the Executive Committee with regard to the selection of external auditors or specialized audit consultants.

Board Options/Fiscal Impacts

Option #1

Authorize the General Auditor to enter into a contract with the firm of KPMG, LLP, (with Vasquez Farukhi & Company, LLP, as subcontractor) for required Internal Audit Support Services for a three-year period commencing July 1, 2000, and for a maximum amount payable of \$1 million.

Fiscal Impact: Approximately \$300,000 per year, and not to exceed \$1 million during the three-year term of the agreement.

Option #2

Reject the recommendation to award the proposed contract for Internal Audit Support Services and consider other alternatives, including hiring a different firm(s) or authorizing the General Auditor to hire new permanent staff to perform the work contemplated to be performed by the proposed co-sourcing agreement.

Fiscal Impact: Estimated to be approximately the same as Option No. 1.

Staff Recommendation

Option #1.


General Auditor

4/24/2000
Date

Attachment 1

The hourly billing rates for services to be rendered under the Internal Audit Support Services Agreement with KPMG, LLP (and Vasquez Farukhi & Company, LLP, as subcontractor) during the period July 1, 2000 through June 30, 2003 will be as follows:

<u>Job Classification</u>	<u>Contract Rates</u>
Partners	\$200
Senior Managers	\$180
Managers	\$170
Supervising Senior Accountants/Senior Consultants	\$130
Senior Accountants	\$120
Consultants	\$120
Staff Accountants	\$100
Assistant Accountants	\$ 90

These rates exclude any necessary transportation or travel costs that may be necessary to perform the services required. KPMG will include such costs in the services billings for the firm and its subcontractor.