

Presentation From The Port Auditor On Best Practices Related To External Audit And Public Audit Oversight Committee Members With Direction To Staff

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Overview

- Importance of audit quality
- Background on the Port's external audit services
- Request for proposal best practices
- Background and views on mandatory firm rotation and possible alternatives
 Benchmarking
 Concluding thoughts



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Why Audit Quality is Important to Audit Purchasers

Per the AICPA, Quality financial statement and compliance audits can help:

- ✓ Fulfill fiduciary responsibility;
- Obtain assurance related to the financial integrity of funded programs;
- Identify possible noncompliance and other issues early to avoid interruption of current funding;
- Lower the risk of future noncompliance; and
- Strengthen the ability to secure additional funding in the future.

The RFP process can be beneficial in identifying new firms, creating competition and allows for a focus on specific criteria to be evaluated.

A successful RFP process can help the Port identify the best services available and it can also help keep costs and time for the audit process itself.



Background - External Audit Services Page 5 of 25 A

- The Port of San Diego uses external audit services to complete the basic financial statement and single audits annually.
- The Port completed a request for proposal (RFP) for external audit services in 2013 and selected the audit firm Macias Gini & O'Connell LLP (MGO).
- The original agreement was for 5 years (three years with two one-year options). Since then, the agreement has been extended twice for an additional 4 years. Total years with MGO will be 9 years with completion of the FY21 audit.
- RFP for external auditors will commence this summer for FY22 audit.
 BPC 776 does not have set RFP or rotation mandate.



Best Practices for Audit RFP's

- Best practices outlined by the AICPA and GFAO:
- Governmental entities should undertake a full-scale competitive process for the selection of auditors at the end of the term of each audit contract.
- Determining the audit engagement term.
- Encourage as many qualified auditors as possible to submit proposals.
- Evaluation committee perform evaluations with specific criteria developed (i.e., minimum standards, technical criteria and price).
- Documenting the agreement (i.e., scope, rates, professional standards, etc.)
- Monitoring of external audit work performance by the audit committee.



Mandatory Firm Rotation (MFR)

A potential course of action at the end of an audit contract is MFR. This practice requires an entity to select a new auditor at the completion of the service agreement.

Firm rotation has both advantages and disadvantages (IIA and PCAOB):

Advantages	Disadvantages
Increased independence and objectivity	Steep learning curve, loss of knowledge
Potential for fresh eyes and perspective	Poor quality audits
Over time, potentially increased quality of work	Opinion shopping, diminish role of audit committee
Potential for lower price	Increased costs



Views on MFR:

- EU is transitioning to MFR with rotation required every 10 years. An additional 10 years can be added if an RFP is performed, and same firm wins the bid.
- Some city councils and non-profits have elected to require MFR.
- PCAOB has not recommended MFR, has recommended partner rotation and in 2017 requires disclosure of how many years an external auditor has provided audits.



Views on MFR:

- > AICPA and IIA is not in favor of MFR.
- GAO "believes that MFR may not be the most efficient way to strengthen auditor independence and improve audit quality" and "fairly certain that there will be additional costs".
- GAO survey indicated almost all large accounting firms and Fortune 1000 companies publicly traded companies believe cost would outweigh benefits.



Alternatives to MFR From the IIA

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- Circumstances where the Board would require audit firm rotation such as in the case of material restatements (restatements which result in the Company's filing an 8k removing reliance on a prior filing), significant frauds in the companies audited, or other indicators of audit failure which impact investors.
- Increased disclosure about the audit committee's role in overseeing the quality of the audit, including its periodic evaluation of auditor independence.
- Providing audit committees, the ability to request the PCAOB perform a directed inspection of the company's audit with reporting directly to the audit committee.



Alternatives to MFR From the IIA

- A requirement that the audit committee solicit bids from other auditors at intervals per discretion of applicable governing bodies.
- > Greater use of internal audit as outlined in the next bullet point.
- Partner rotation (CA requires rotation every 6 years), lead staff rotation. oraft Presentation



Benchmarking of Audit RFP Frequency

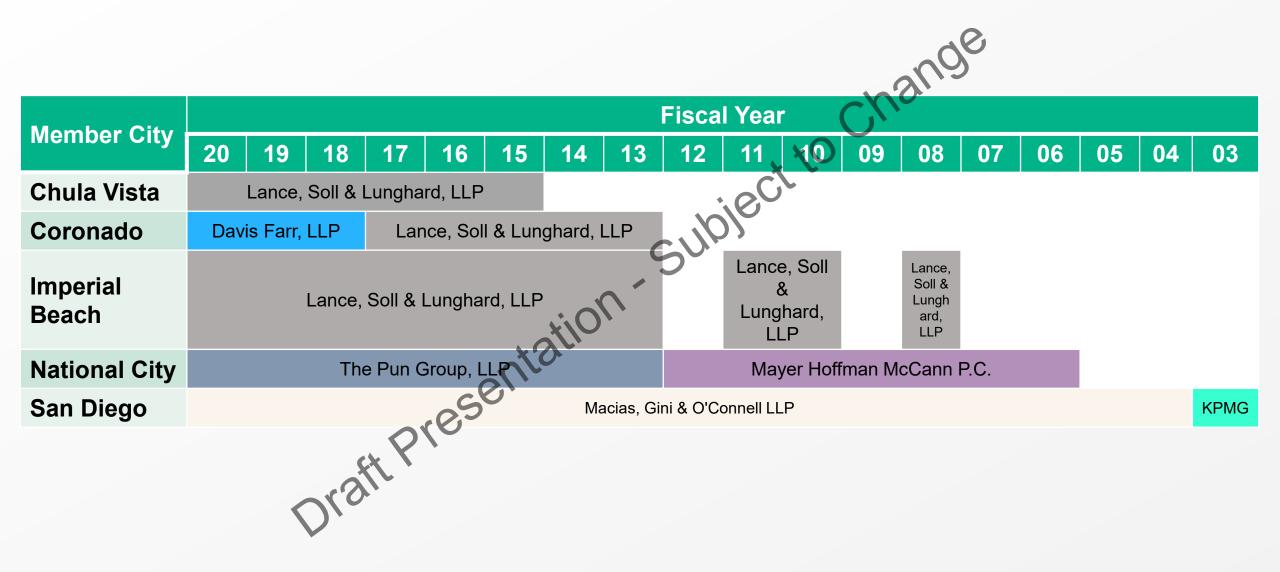
Benchmarking was performed against Port member cities, regional agencies and greater California agencies to determine the standard for RFP frequency. It has been concluded that audit services are typically competed every 3-5 years depending on end of the contract or if option years were raft Present executed.

City/Agency	Agreement Length (Year/Option)
San Diego Imperial Beach	5 Years
Imperial Beach	3 Years + 2 Year Option
Chula Vista	5 Years
National City	3 Years + 2 Year Option
San Diego Airport	3 Years + 2 Year Option
SDCERS	5 Years
Port of Los Angeles	3 Years + 2 Year Option
Port of Hueneme	3 Years + 2 Year Option
Palo Alto	5 Years
City of Los Angeles	3 Years + 2 Year Option
Sacramento	1 Year + 4 Year Option

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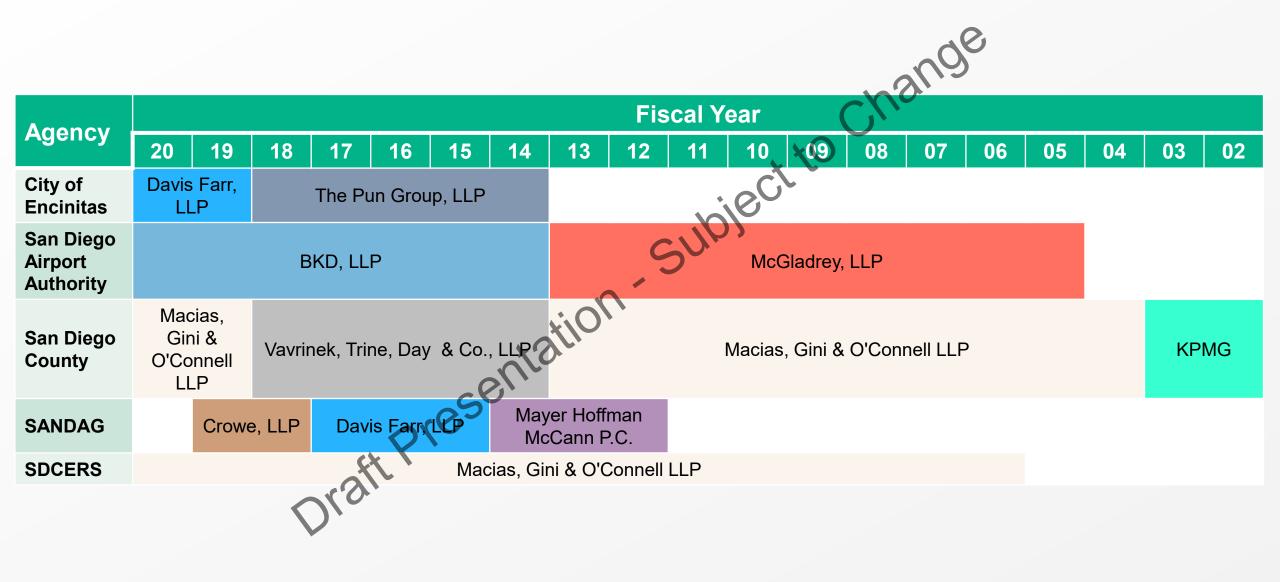


Benchmarking of Audit Firm Years of Service



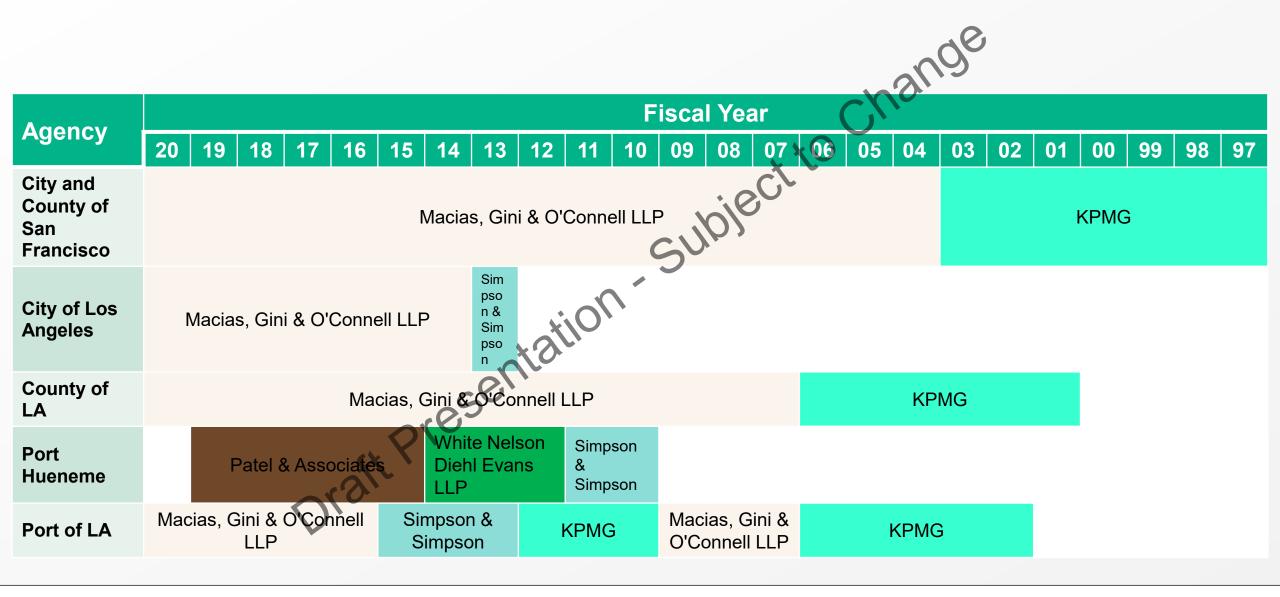


Benchmarking of Audit Firm Years of Service





Benchmarking of Audit Firm Years of Service





Concluding Thoughts

- Best practice is to complete a competitive RFP process at the end of the service agreement.
- > Typically occurs every 3-5 years.
- MFR has both advantages and disadvantages but has not been widely adopted/recommended in the US.
- Consider partner rotations and lead staff, increased audit committee and Board oversight of selection and performance reviews of external auditors.



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Best Practices Subje Related To Public Audit Oversight **Committee Members**



Overview

- Importance of the Audit Committee
- Background on the Port's Audit Oversight Committee (AOC)
- oraft Presentation Subject to > Audit committee makeup and term limits best practices
- Benchmarking
- Concluding thoughts



Why Audit Committees Are Important

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Per the IIA, the audit committee can provide advice/guidance on:

- Governance, risk management and control practices.
- Initiatives on values and ethics.
- ctto Oversight of the internal audit function.
- Oversight of the external audit function; and
- Financial statements and public accountability reporting. oraft Presentati



Background - AOC

- The Port of San Diego AOC consists of five members. Two Port of San Diego Board of Port Commissioners and three public members.
- BPC Policy Number 776 governs the AOC. Per the policy, members serve three-year staggered terms to ensure continuity. Currently, there is no set term limits.
- The AOC provides recommendations to the full board for consideration and discusses relevant audit topics with the Port Auditor/subject matter experts quarterly.
- In March 2021, the AOC and Board recommended best practice research on term limits and number of committee members.



Best Practices for Audit Committee's

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- Best practices outlined by the IIA Public Sector and GFOA:
- The audit committee shall consist of members (typically 3-5), the majority of whom shall be independent of the organization. The members should collectively possess sufficient knowledge of audit, finance, IT, the law, risk, and control.
- Length of term (typically 3-4 years) and should be staggered to ensure continuity.
- Term limits should be determined by the organization (consider need for new perspectives, keep board dynamic vs. institutional knowledge and continuity).



Benchmarking of Audit Committees

Benchmarking was performed against other public sector audit committees. Benchmarking revealed committee sizes (2-8 members), term length (3-5 years) and term limit (3-8 years).

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City/Agency	Term Length	Number of members Wublic/Internal)	Term Limit
San Diego	4 years and	5 (3/2)	2 terms*
SDCERS	4 years	5 (3/2)	8 years
SD Airport	3 years	7 (3/4)	2 terms
SANDAG	2 years	5 (3/2)	5 years**
County of Orange	4 years	8 (5/3)	4 years
Port of Los Angeles	5 year	2 members of the board	-
Port of Seattle	3 year	3 (1/2)	3 year



Concluding Thoughts

- The AOC currently follows many of the outlined best practices: chang
 - Term length is appropriate
 - Staggered terms to ensure continuity
 - Number of committee members is appropriate
 - Majority of members being outside of the organization (3 public)
 - Knowledge and qualification of members meet and exceed standards
- While term limits are not required, and have advantages/disadvantages, benchmarking revealed most agencies have established term/year limits.
- Other options include reapplying at end of each term or requiring a term break at the end of the term to reapply. Draft Pre

What's Next From the OPA

- Continue to implement best practices to the office and make necessary changi policy updates
- Draft Presentation Subject to SDCERS pension presentation, AOC directed
- Annual financial audit presentation



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Questions, Discussion, and Direction to Staff