Programmatic Portfolio Company Reporting

Access Holdings

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Introduction and Role of the Audit Committee

This guidance is meant for the use of Access Holdings Management Company LLC (Access) private equity (PE) investees to assist them in selecting their auditors. Larger businesses and public companies will generally undertake a more complex and exhaustive process to select their auditor and will need to comply with all applicable US regulatory guidelines. Companies operating in jurisdictions other than the United States also need to comply with their local regulatory guidelines.

A primary responsibility of the Audit Committee of the Board of Directors is to recommend the annual appointment of the auditors to the Board of Directors, to determine auditor remuneration, manage the auditor relationship, evaluate the performance of the auditor, and from time to time consider whether it is appropriate to investigate changing the auditor. While management should have a good working relationship with the auditor, the auditor reports to the Audit Committee and not to management.

As a general observation and ignoring security regulators' guidelines for public companies in various countries, changing auditors should be done rarely if at all. It is a red flag to lenders and investors. If it does occur the Board of Directors must be able to clearly articulate reasons for the change which will withstand outside scrutiny.

Selecting the Candidate Auditing Firms

The very first step in selecting audit firms which will be asked to propose on providing audit services, is to ensure that the firms are independent of the company. Auditor independence can be compromised by non-audit services the firm is currently providing to the company, by audit and non-audit services provided to major shareholders, methods of compensation for services provided by the audit firm (such as contingent based fees), by existing relationships between the audit firm and directors or senior management. Independence in appearance is as important as independence in fact. If an audit firm is being considered the question of independence must be investigated by the Audit Committee before an invitation to propose is sent out.

Which audit firms should be considered? The liquidity events that PE investees must keep in mind generally include an Initial Public Offering (IPO). If this a possible future for the company, as a matter of good business practice we might want to only consider audit firms in the top 20 in the US (See https://moneyinc.com/top-accounting-firms-in-the-united-states/). In general, the larger the likely IPO the larger the audit firm should be. In that regard if sizeable IPO is contemplated it is probably best to pick one of the top 6 – the big four for large IPOs (in order of size PricewaterhouseCoopers, Deloitte, Ernst and Young, KPMG) – the next two for medium sized IPOs (in order of size Grant Thornton and BDO). Firms below the top 6 can be considered for expected smaller IPOs or where an IPO is an unlikely liquidity event. In 2020, 2/3rds of US public companies were audited by the top 10 audit firms.

How many firms should be invited to propose? As PE investees and private companies, we are not bound by regulator guidance. The more firms that are invited the more director and senior management time will be required to ensure the candidates are able to develop the necessary understanding of the company to enable them to produce a credible proposal. Common business practice would be to ask two or three firms to establish a competitive process. If the members of the Audit Committee believe that they already know which firm they want, a proposal process with one firm is acceptable business practice as long as they believe this is the best choice and there is no independence issue. References from other audit clients should be required for the senior members of the audit team.

Note that competitive proposal will likely not result in reduced audit fees. The Audit Committee should be able to judge whether the fees are reasonable for the services rendered and any lowball initial fee, if accepted, will shortly disappear in subsequent years.

How can the list of firms be narrowed to two or three? This is where the experience and knowledge of the Board of Directors and the CEO and CFO is important. In addition, Access has a Board of Advisors who can be asked to help and Access executives have experience in selecting auditors as well. Lastly a review of pending litigation against the firm, regulatory actions against the firm, and recent press about the firm should be done.

Audit Proposal Process

With audit firms whose independence has been confirmed selected to be invited to propose, the proposal process should be established.

One person at the company, generally the CFO, should be charged with managing the process. A small team of the CFO, one or two members of the finance group to do the legwork and the Chair of the Audit Committee should form the working group managing the process.

Decision makers and influencers on the decision of which audit firm to engage include the Chair of the Audit Committee, other Audit Committee members, the CFO, the Controller, the CEO, CTO, VP Tax, and other operating leaders in the company. Prepare a list of who will be asked to participate in the decision.

Steps in the audit proposal process are:

1) Select audit firms to be invited.
2) Establish the working group to manage the process.
3) Prepare request for proposal (RFP) which should include a complete list of services on which the audit firms will be invited to propose, including the timelines that are expected to be adhered to.
4) Produce a timetable for the process. Generally, this will take 4-6 weeks. The steps are:
    a) Inform directors and senior management that the process is underway and that they will be involved through meetings with the audit firms.
    b) Gather all the data and documents that the auditors are likely to require.
    c) Establish the evaluation criteria that will be used to select the preferred audit firm.
    d) Prepare an outline of the written proposal contents (and the contents of the oral presentations if desired).
    e) Communicate with the existing auditors, maintaining a positive relationship. Decide if they are being invited to propose or not and articulate the reasons for the proposal process and for not inviting their participation if that is the case.
    f) Contact the audit firms to be invited to propose and send out the RFP.

   g) Arrange auditor site visits and meetings.
   h) Provide feedback to the audit firms during the process.
   i) Gather feedback from company directors and management on their meetings with the auditors.
5) Receive, review, and evaluate the audit firm written proposals.
6) Conduct auditor oral presentations.
7) Evaluate the audit firms against the evaluation criteria and reach a preliminary conclusion.
8) Consult with the decision makers identified earlier and reach a conclusion on which audit firm will be appointed.
9) Hold a Board of Directors meeting in which the Audit Committee Chair and CFO present the results of the process, recommend appointment of the audit firm for the current year, and approve the Audit Committee recommendation
10) Communicate the decision to the firms that were asked to propose.

Timing

The time to change auditors is after the completion of the most recent fiscal year end financial statements, so in Q1 or Q2. If the process is delayed beyond Q2, the auditors will not be able to carry out significant audit work during the year or establish good working relations with the finance group. The result will be an unnecessary crunch at year end for the finance group and the auditors.

Invitation to Propose

The invitation to propose should be in the form of a short letter outlining the process and establishing the timetable:

Dear

The Board of Directors of COMPANY NAME has decided to review the audit arrangements for the year ending XX. The purpose of this letter is to invite your firm to propose for the audit and other non-audit services, to advise you of the process we will use to select the firm to be appointed as our auditor and of the timetable we will use. We have invited your firm and Firm Name to propose to provide these services.

In addition to the audit of our consolidated financial statements for the year ended XX, we require the auditor to provide the following non-audit services, LIST.

You will be required to submit a written proposal which should cover LIST and any other information you feel we should have to help us make this decision. You will be invited to make a presentation to the company's working group, who are managing the process. The members of the working group, led by NAME POSITION are NAME POSITION, NAME POSITION.

The key dates for the proposal process are from XXX to YYY meetings between your firm and our directors and management, XXX the date by which your written proposal should be delivered, XXX the date on which you will be invited to make an oral presentation to our working group, and XXX the date on which we will communicate our decision to you.

Please confirm your independence, your willingness to be considered for appointment as our auditor of the consolidated financial statements of COMPANY for the year ending XX and your ability to complete the process we have outlined in the timetable we propose for completion of the proposal process.

Signed by the leader of the audit proposal process working group.

Written Audit Proposal Contents

It is a good idea to outline the major parts of the written audit proposal. This gives a degree of consistency for comparing the audit firms and ensures that the proposal covers matters the working group considers important. The invitation to propose should invite the audit firm to include other matters they think should be relevant to the decision. A good audit proposal will be short but effective – a dozen pages plus appendices for CV's, fees, industry expertise and so on is about right.

It is not necessary to cover everything listed here, rather choose the items that matter most to the decision process. Written audit proposal contents could include:

- Why your firm should be our choice (look for benefits, not features).
- Ensuring the maintenance of your firm's independence including providing non-audit services.
- Your firm's organization and structure as relevant to this engagement.
- Industry expertise, relevant client lists.
- The audit team (including their CVs and emphasizing their relevant experience and tenure with the firm).
- 2 or 3 personal references for each of the audit partner, audit senior manager and tax partner.
- The audit approach (including the use of computer assisted audit tools and techniques, the planned combination of substantive testing and controls-based audit procedures, key risks and how they will be addressed, timing of work).
- Understanding of our business risks.
- Audit quality control processes.
- Processes for continuous improvement in the audit.
- Working with our VP tax, CTO.
- Transition from the current auditor.
- Audit fees (including in an appendix a breakdown of hours and rates by levels of staff in support of the fees quoted, as well as, rates by levels of staff for overage billings, as these can sometimes differ). Generally, auditors do not like to give this information. Ask for it anyway.
- Non-audit services, how they will be provided by whom (including CVs) and related fees.

A Word on Independence

Audits of private companies will be conducted using AICPA auditing standards. These are not as stringent as SEC auditing standards. Compliance with SEC auditing standards would raise the fees charged to our companies significantly and is not necessary. Of particular concern though is the difference between the two in the matter of independence.

SEC independence standards include a list of proscribed services. If the audit firm provides these services, their independence is deemed to be compromised. Examples include management functions such as preparing financial statements and preparing journal entries to be posted in the company's books. While the company is private, having the auditor provide these services is not as important. However, if auditors are deemed not independent for public company purposes, how can their independence not be impaired in fact if they do this work for private companies? And if an IPO is planned then the years to be reported in the S-1, the document that is produced for an IPO, must have audits that meet SEC independence standards. Typically, three years of historic financial statements are included in the S-1.

Additionally, certain services provided multiple years prior to the three years of historical financial statements referred to above can result in perpetual lack of independence under SEC standards.

So, it is important to plan ahead. We can and should instruct firms proposing to do our audits to audit to the AICPA standards, but when it comes to independence, to manage their independence to SEC standards.

There is a proposal under consideration to allow financial statements included in an S-1 to meet SEC independence standards for the current year only, and historical financial statements can be produced with audit opinions from firms that only meet AICPA standards of independence.

Stay tuned, but in the meantime…

Meetings with Management and Directors

The audit firms will have to meet with directors and senior management to gather sufficient information to produce an effective proposal. Managing this process is important, balancing the trade off between good access and consuming too much management time. The auditors should be able to meet more than once with the members of the working group, finance staff, the CTO and their staff, the VP tax and their staff. They should be able to meet with anyone else as well, the CEO, operational management, the Board Chair, other Audit Committee members and so on. But they should be asked to aim to limit meetings with these individual directors and managers outside the core group to one with each.

Anyone meeting with the audit firm members should be asked to complete a simple standardized questionnaire and submit it to the working group leader, to gather impressions as widely as possible. Avoid scales of 1-10 and ask for narrative commentary instead. The questionnaire, identifying the reporter, date(s) of the meeting(s) and audit firm personnel involved, could include:

- Did they demonstrate a clear understanding of the business, industry, market?
- Do they understand our business issues, and will their work address them?
- Do the audit firm personnel have requisite expertise and experience?
- Are they professional?
- How was the personal chemistry?
- Will you be comfortable working with them?
- Will they fit in with our culture?
- Do you have any concerns about any of the audit firm members you met?
- Any other comments?

A classic question to get people talking is - what are you expecting from us as your auditors? This is legitimately asked of the core working group members and they should have a ready answer. Everyone else can respond with - that is not really my area. What should I expect from you? And it is worth taking note of the answer in the questionnaire.

Feedback During Proposal Process

The question sometimes arises as to whether it is appropriate to offer feedback to the audit firms during the proposal process. This is not a government regulated process. Its purpose is to get us the best possible proposals. It should not be used a way of putting a thumb on the scales for one firm over the other. But it is appropriate to offer feedback whenever it is likely to help the audit firm produce a better proposal.

The Lead Audit Engagement Partner

Probably the most important part of the proposal is who will be the lead audit engagement partner. They will set the tone, combine technical competence with sound judgement calls, manage the relationship, ensure that a quality audit has been done, offer insights and additional valuable services.

Judging whether the person proposed for this role is the right one for the company is a challenge. Our PE investees are generally small and medium-sized enterprises (SMEs). It is unreasonable to expect that the most senior audit partners will be proposed, and frankly probably undesirable in any case. The ideal candidate will have industry experience and expertise (but there are benefits from a broad range of different industry experience as ideas can cross from one industry to another). They should have a good portfolio of clients. But the question arises that if the proposed partner has a lot of management responsibility and a big portfolio of clients, will they have the time to devote to your audit and other services? Since our invitation to propose asks for hours and rates to support the audit fee quote, we will be able to judge whether the partner plans to spend enough time on our account. That, their CV, their references, and the observations of our directors and management about their interaction with the proposed audit partner will help us decide if we have the right person in this crucial role.

The Audit Proposal team should evaluate from the meetings and interviews conducted how the Lead Audit Engagement Partner interacts with the other members of their proposal team, including if the Lead Audit Engagement Partner has worked with the rest of the engagement team previously. The Lead Audit Engagement Partner having a strong working relationship with the members of the engagement team included in the proposal will assist ensuring that the services we seek to receive are delivered timely.

Evaluation Criteria

It may be appropriate for large companies with complex decision-making processes to invite multiple audit firms to propose and to have a scorecard approach to evaluation criteria, with numeric ratings, weighting by importance and so on. This is not necessary for our companies. Keep it simple and select evaluation criteria that matter most to the working group. Evaluation criteria could include:

- A quality audit at a fair price.
- Independence.

- Lead audit engagement partner, seniority, influence in the firm, capacity to devote sufficient time to the engagement.
- Capacity of the senior team to take on the work, expertise, experience, professionalism, cultural fit.
- Good working relationships (references obtained for senior team members).
- Industry expertise.
- Understanding the company, the business, the industry, the market.
- Audit approach – understanding of risks and how they will be addressed.
- Compliance with written proposal requirements, additional information provided, quality of written proposals.
- Performance during the oral presentation and quality of the oral presentation.
- Use of technology in carrying out the audit (can ask for a live demo in the presentation session).
- Quality assurance processes.
- Ability to bring insights and add value.
- Ability to ensure an effective transition from current auditors.
- Audit fees including detailed hours and rates by level to support fees.
- Other non-audit services offering, staffing, fees.

Data for the Auditors

The auditors will require a great deal of information as part of their proposal process. To the extent possible it should be gathered before the invitation to propose is sent out. The following is a very long list of what they might ask for:

Org charts and job descriptions

- Corporate structure including explanations for the existence of some entities, whether consolidated, equity accounted, or cost accounted, all ownership details, locations of operations.
- Personnel org chart.
- Finance group org chart and job descriptions.

Strategic plan, budget, financial statements, and finance group

- 3-year strategic plan.
- Next year's budget.
- 2 or 3 years of audited annual financial statements.
- Current year interim financial statements.
- Current year to date financial statement compared to budget with explanations.
- 13 week rolling cash flow forecast.
- Prior year auditors' report.
- Prior year's audit and non-audit service fees.
- Period end closing calendar(s).
- Intercompany transactions and balances processes.
- Related party process.
- Consolidation process.

- Accounting policy documentation supporting significant accounting policies disclosed in financial statements.
- Accounting policy manual.

Governance

- Enterprise risk management documentation and reporting.
- Credit risk policy.
- Insurance risk policy and insurance coverage.
- Audit Committee plan, calendar, meeting minutes for last two years, members and their CVs.
- Board of Directors plan, calendar, meeting minutes for last two years, members and their CVs.
- Board of Directors strategy documents.

System of Internal Control

- Risk and key controls matrices.
- Documentation of all accounting cycles including flow charts and narratives.
- Results of Internal Audit work over last two years.
- Material weaknesses and significant deficiencies reported in last two years and their resolution.
- Internal control recommendations made by the auditors.

IT Systems

- Overview of IT environment.
- IT org chart and CVs of key members.
- General IT Controls.
- Overview of key IT systems.
- IT Risk and security controls.
- Recently completed and ongoing major IT projects.
- IT budget

Other

- Tax compliance, audit status, uncertain tax positions, deferred tax assets and liabilities, tax strategies.
- Debt structure and details.
- Equity classes of shares authorized, issued, special rights, dividends.
- Special Purpose Entities (SPEs).
- Inventory of leases.

It is important to remember when providing certain audit requests that some of these requested documents might be confidential in nature, such as previously received management letters from the existing audit firm. In instances where preapproval is required to distribute information to those firms proposing, proper consideration and planning should be given before providing this information.

Additionally, the firms proposing will ask for this information as a way of evaluating the organization and sophistication of the company, in addition to the actual contents contained within. It is prudent that when providing this information that best practices be consistently followed with sharing information.

In instances where some of the information might not be prepared or monitored, that is to be expected, and internal discussion should occur prior to preparing these requests.

Conclusion

Proper diligence needs to be done when the Board of Directors considers changing auditors. If the Board decides to proceed with the selection of new auditors, it must be understood that this will be a time consuming and important process. The process will be managed by the Audit Committee and the company with the Audit Committee making the ultimate recommendation to the Board on the selection of auditors.

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