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From: Auditor of State's Audit Administration
To: All IPA Firms
Subject: Contract Modifications
Date: September 8, 2014

We have noted recurring issues regarding contract modifications that we want to bring to the attention of all contracting IPA firms. These issues relate to the timing of modification approvals, as well as the description of the modifications, adjustment to hours for the engagement and requirements for a bundled contract.

Circumstances Requiring a Modification:

Section VI(B)(4) of the Request for Proposal (RFP) allows for modifications **only** related to issues which were not known at the time of the original proposal, such as changes in accounting or professional standards, changes in reporting entity, significant funding changes, significant additional procedures requested to be performed by the AOS after the contract is in place, etc. Client issues identified in the prior audit report are known and should be considered in the original proposal unless specifically known to have changed. Modifications related to previously known circumstances are not appropriate.

Modifications are not only necessary in situations when additional procedures are required but are also required in situations where a reduction in hours/costs is appropriate. For example, if the original proposal's hours/cost was based on the assumption the client would have two Single Audit major programs, and three major programs are actually required, an increase in the hours/cost would be appropriate; however, if only one major program is required, a reduction in the hours/cost would be required. Similarly, if the original proposal assumed the client's financial statement would be presented on a cash-basis, but the client presents on a regulatory basis, a reduction in hours/cost would be expected.

Modifications from Audit to AUP:

Eligibility Checklist

Auditor of State Bulletins 2009-012 and 2012-007 outline the requirements for client eligibility to receive reduced services of agreed-upon procedures (AUP) or a basic audit. Additionally, the *Scope of Work Performed* section of the RFP's Appendix A for any potentially eligible client requires the engaged firm to obtain the eligibility checklist and conduct an initial evaluation of the client's eligibility for these reduced services. The firm is also required to provide this initial evaluation to the appropriate AOS liaison for final determination of eligibility. In many cases, the requirement to submit the checklist to the AOS has been misinterpreted as only required when the firm initially determines the client is actually eligible for reduced services; however, in order to ensure all potentially eligible clients are evaluated for eligibility, firms must submit an

eligibility checklist for every potentially eligible client prior to commencement of the engagement for each applicable audit period.

Budgeting for an AUP Engagement

In reviewing modification requests to change an engagement from an audit to an AUP, we have noted firms reducing the hours/cost by a certain percentage and/or concentrating on the cost rather than building the budget based on the procedures to be performed. While the hours for an audit will fluctuate depending on whether the financial statements are presented on a GAAP, cash, or regulatory basis, the AUP procedures are the same regardless of the financial statement presentation. It is; therefore, not a prudent approach to determine the budget for an AUP engagement as a percentage of the original contracted hours/cost for the audit. Rather, the budgeted hours should be determined based upon the procedures to be performed. When hours submitted for a modification from an audit to an AUP engagement appear inappropriate, we will request the firm to submit the detail of the engagement budget and/or an explanation for the hours budgeted.

Timing of Contract Modifications:

As further described in Section VI(B)(4) of the RFP, a fully executed Modification/Extension Agreement must be in place **prior** to changing the scope of the engagement and/or performing any additional procedures. Incidents of firms submitting requests for a modification after the procedures have already been performed or after the report has been submitted to our Center for Audit Excellence have occurred. In the case of modification from an audit to an AUP, firms have modified the engagement based on the AOS' final approval of the eligibility checklist without ensuring an approved Modification/Extension Agreement is in place. The approval of the eligibility checklist alone is **not** sufficient approval to commence an AUP engagement.

Modification/Extension Agreement Form:

Completing the Form

We have noted some recurring issues with completion of Section II of the Modification/Extension Form, as follows:

- The “Fiscal Period(s) Impacted by this Modification/Extension” section have been left blank or completed incorrectly.
- The “Detailed Explanation for Modification/Extension” section does not always provide enough specific detail to determine the justification for the modification.
- The “Impact on Cost” section has been completed incorrectly in that, if an extension, the “Original Contract for the Impacted Period” should be blank or zero or if a modification, it should include the contract cost for the impacted period(s) only. The change for the modification or extension should appear on the “Current Modification for Impacted Period” line with the new total for the impacted period(s) appearing on the “New Contract Total for Impacted Period.”

Modifications Related to a Bundled Contract

When, for efficiency, we bundle multiple entities in the RFP, individual contracts are still required for each entity. Therefore, just as a separate Memorandum of Agreement is required to be executed for each entity in the bundle, if a modification is required for one or more entities in the bundle, a separate Modification/Extension Agreement form is required for each entity's modification.

Questions and Concerns

If you have any questions or concerns, please email IPACorrespondence@ohioauditor.gov.